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THE POTENTIAL IMPACT OF THE UNITED STATES-CANADA FREE TRADE AGREEMENT ON THE AMERICAN STEEL INDUSTRY

HEARING

BEFORE THE

SUBCOMMITTEE ON ANTITRUST, MONOPOLIES AND BUSINESS RIGHTS

OF THE

COMMITTEE ON THE JUDICIARY AND THE SENATE STEEL CAUCUS UNITED STATES SENATE

ONE HUNDREDTH CONGRESS

SECOND SESSION

ON

THE UNITED STATES-CANADA FREE TRADE AGREEMENT—TO DETERMINE ITS IMPACT ON DOMESTIC STEEL PRODUCTION

MAY 11, 1988

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THE POTENTIAL IMPACT OF THE UNITED STATES–CANADA FREE TRADE AGREEMENT ON THE AMERICAN STEEL INDUSTRY

WEDNESDAY, MAY 11, 1988

U.S. SENATE, SUBCOMMITTEE ON ANTITRUST, MONOPOLIES AND BUSINESS RIGHTS, COMMITTEE ON THE JUDICIARY, AND THE SENATE STEEL CAUCUS,

Washington, DC.

The subcommittee met, pursuant to notice, at 10:03 a.m., in room SD–226, Dirksen Senate Office Building, Hon. Howard M. Metzenbaum, chairman of the subcommittee, presiding.

Also present: Senators Specter and Rockefeller.

Senator METZENBAUM. The hearing will come to order.

OPENING STATEMENT OF SENATOR HOWARD M. METZENBAUM

Today, the Senate Steel Caucus meets in conjunction with the Judiciary Subcommittee on Antitrust, Monopolies and Business Rights to consider the potential impact of the U.S.-Canada Free Trade Agreement on the American steel industry.

On the surface, the Free Trade Agreement would not seem to have much impact on steel. The only provision directed specifically at steel outlines a 10-year schedule for the elimination of steel tariffs. But many other provisions in the agreement would have an impact on steel. For example, it would negate the Buy American Act, which required the Federal Government to purchase American materials. Last year, the Steel Caucus went to great lengths to preserve the Army Corps of Engineers' Buy American policy. Under the Free Trade Agreement, our efforts will have been for naught; the Corps could be required to use Canadian steel for civil works projects in the United States.

It seems that what the trade agreement does not say could affect American steel at least as much as what it does say. For instance, the Free Trade Agreement omits any discussion of the potential competitive advantages gained through favorable exchange rates.

The recent decline in the U.S. dollar against the yen and European currencies has reduced steel imports from those countries, increasing the competitiveness of our domestic industry. However, because of the current value of the Canadian dollar, the Canadian steel industry has a significant edge over American steelmakers. The U.S. dollar rose significantly against the Canadian dollar in 1987, preserving the Canadian steel industry's ability to produce steel and ship it to the United States at relatively low costs.

This Canadian cost advantage gives Canadian steel a substantial competitive advantage. Take the cost of labor. Nominally, American and Canadian workers earn about the same wage. But the falling value of the Canadian dollar has reduced unit labor costs for Canadian producers by about 20 percent compared to U.S. steelmakers. Thus, Canadian steelmakers were able to produce a finished metric ton of steel at over $100 below the cost of American manufacturers last year.

This competitive advantage has been translated into increased Canadian import penetration of the U.S. market. Canada exports 20 percent of its steel production, three-fourths of that amount to the United States. Since 1984, U.S. imports of Canadian steel have risen rapidly, and Canada now ranks second only to Japan as a source of foreign steel in the United States.

The success of the Canadian steel industry is impressive, but it should be remembered that they did not do it alone. For nearly a generation, the Canadian steel industry benefited from far more generous tax allowances and depreciation rules than U.S. steelmakers received. Two Canadian works are, in fact, owned by provincial governments and have received substantial state subsidies.

Like the U.S. industry, the Canadian steel industry has been forced to reduce capacity and employment in the 1980's. But this downsizing has not produced the problems currently facing the U.S. industry.

In the United States, every ton of steel costs an additional $20 just to cover the costs of providing promised retiree benefits. By 1991, that cost will climb to $34 a ton. The Canadian industry has downsized without incurring such substantial costs.

The point is that, although the American steel industry has recently begun to show signs of renewal, American steel has not fully recovered from the depression of the 1970's and early 1980's. Make no mistake: The American steel industry still needs our help.

No product is more important to the economic health or national security of the United States than steel. From aircraft carriers to automobiles, from filing cabinets to lunch boxes, steel is part of every American's daily life. Our Nation simply could not exist without a strong steel industry.

We are holding this hearing to make sure that the Free Trade Agreement does not give Canadian steel any further advantages over the American steel industry. Congress is currently drafting the rules for implementing this agreement, and we want to be sure it reflects our concern for the American steel industry. We want to be sure that this Free Trade Agreement is also fair to the American steel industry.

Our witness list today: Ambassador Clayton Yeutter, U.S. Trade Representative; Mr. Milton Deaner, president of the American Iron and Steel Institute; Mr. Robert Garvey, chairman of the National Steel Producers Association and chairman of North Star Steel; Mr. C. Philip Weigel, who is a member of the executive committee of the Specialty Steel Industry of the United States, and president and chief executive officer of Latrobe; and Mr. R. Wayne Atwell, senior vice president for Investment Research at Goldman, Sachs & Company.

Let me say that the exchange rate is of crucial importance to our discussion of the Free Trade Agreement. The Chair of this meeting is much disturbed about the fact that the Treasury Department, that the Secretary of the Treasury did not see fit to participate in this meeting. The Treasury participated directly in negotiating the FTA, but they decided that it was too sensitive an issue to come and discuss with us in an open forum.

I do not understand that. If it is something that they can discuss with the Canadians, I do not understand why they cannot discuss it with a committee of the U.S. Senate or with the Steel Caucus of the U.S. Senate. I might find a little bit better understanding if this was the first time the Treasury Department was reluctant to meet with the Steel Caucus, but it is not.

In March, Treasury initially refused to meet and discuss the upcoming World Bank vote on a loan to revamp the Mexican steel industry. Once we met, the Secretary of the Treasury actually changed his position on the World Bank loan as a result of our discussion.

Clearly, we can make progress when we meet to discuss issues. But in this case, it seems that Treasury has made up its mind and is not even open to discussion. If the Senate is to act responsibly in considering the FTA, we need to have all the facts before us. When the Treasury Department and the Secretary of the Treasury refuse to appear to present the facts, it makes our job that much more difficult.

I have sent questions on the FTA's potential impact on the U.S. steel industry to Secretary Baker and asked him to answer them in writing. I fully expect that he will respond in a thoughtful and thorough manner, but I want to emphasize that if the Secretary of the Treasury thinks that this Canadian Free Trade Agreement is going to pass the U.S. Senate without his being willing to discuss the substance of it with members of the U.S. Senate, then he better revise his thinking. And if he is too busy to be concerned about this agreement and the impact on the U.S. Senate, then I would say that there may be a rougher road ahead for this agreement than he had anticipated originally.

We do not appreciate his failing to appear before us today. We do not approve of the fact that he was prepared to vote to support the World Bank loan of $400 million to Mexico for their steel industry. And we sometimes wonder whose side he is on.

Senator Rockefeller, we are pleased to have you here. You have been very helpful to the Steel Caucus on all of these issues, and we are very happy to have an opening statement from you.

Senator ROCKEFELLER. I do not have an opening statement. I came to hear what some of the gentlemen that I am now looking at have to say about steel and the Free Trade Agreement. The Free Trade Agreement with Canada is something which, in principle, I find I can support. But when it comes to my vote, I have got to look at my home State in terms of its basic industries. I am trying to do that systematically, fairly and openly, and that is one of the reasons I am here.

Senator METZENBAUM. Thank you very much, Senator Rockefeller.

I am advised that Ambassador Yeutter will not be with us until 11:15, and we certainly understand that.

Our first witness, then, will be Mr. Milton Deaner, President of the American Iron and Steel Institute.

STATEMENT OF MILTON DEANER, PRESIDENT, AMERICAN IRON & STEEL INSTITUTE

Mr. DEANER. Thank you, Mr. Chairman.

I am Milton Deaner, president of the American Iron and Steel Institute. I am speaking today on behalf of our domestic member companies. I think you are aware that we have both Canadian and U.S. member companies.

You advised, Mr. Chairman, that you would like our views on the U.S.-Canada Free Trade Agreement and how it might impact on steel production in the United States.

This is not easy to answer because the quantity and mix of steel production have many determinants, and it is not really possible to isolate the impact of the FTA as a discrete factor. I can tell you that our domestic members have been concerned about the level of steel imports from Canada, and it does not appear that the FTA provisions address this concern. Let me describe our situation.

The President's VRA program went into effect on October 1, 1984. Imports of finished steel from Canada were about 2.4 percent of the U.S. market in 1983, 3 percent in 1984 and 1985, increased to about 3.5 percent in 1986, and rose to nearly 4 percent last year. From 1984 to 1987, when finished steel import market share from VRA countries declined 37 percent, finished steel import market share from Canada actually increased 27 percent. Imports from the rest of the world decreased then from about 26 million tons to 20 million tons, while imports from Canada rose from about 2.5 million to 3.7 million.

Now, domestic members recognize that steel imports from Canada are not necessarily traded unfairly and that Canada's share of the U.S. steel market may not increase in 1988. We have recently read that Canadian producers were targeting imports at about 3 percent. But right now, all we have to go on is the import market share performance record to date.

Our domestic producers point out that the President's program aims to remedy market disruption and unfair trade through a system of bilateral restraint agreements with major steel-exporting nations, and that the absence of such agreement with major exporting countries poses a problem, both for the effectiveness of the program and in terms of equity with those nations who have entered into VRA agreements.

Now, I said at the outset that our domestic producers see nothing in the FTA that in and of itself addresses their concerns about the high level of imports from Canada. Clearly, there is nothing in the FTA that would preclude Canada from entering into a steel VRA, but the Canadian Government would have to be willing to do so. And as far as we know, it remains unwilling to do so.

The U.S. producers readily acknowledge that the Government of Canada and the Canadian steel producers have made attempts to alleviate steel trade friction through implementation of a steel

export monitoring system and have been working closely with the U.S. Government to identify fraud.

Our domestic producers, nevertheless, support ongoing Government-to-Government talks to resolve U.S.-Canadian steel trade friction and continue to hope that Canadian steel trade policy can help maintain the integrity of the VRA program. In that regard, our members appreciate the support of the House and Senate Steel Caucuses in particular.

Beyond what I have already said, it is not likely that the FTA will have any immediate or substantial effect on the level of steel imports from Canada. Our domestic members support the FTA rules of origin to determine the country of origin of steel and other imports, but they have concern about a number of FTA provisions. They include: One of the items that you gave a good bit of attention to in your address—the lack of any provision for dealing with the currency imbalance; the failure to address Canadian Government subsidy practices; the proposed future development of a "substitute" dumping and subsidy trade law regime; the proposed bi-national panel to replace judicial review of dumping and subsidy case findings; and the provision that sets out the timing and the procedure for elimination of tariffs.

On FTA implementing legislation, our domestic members look forward to working both with Congress and with like-minded U.S. industries to ensure that the implementing langauge serves U.S. economic interests. In my written statement, I have listed a number of specific areas where our domestic members have proposals for U.S. implementing legislation.

Between now and year end, our domestic members will re-evaluate their position on the FTA periodically in light of future developments in, one, the implementing legislation and, two, the level of steel imports from Canada.

Thank you, Mr. Chairman. Our producers have appreciated the opportunity to present this statement.

Senator METZENBAUM. Thank you, Mr. Deaner. Would you be good enough to repeat for me at the moment? You had indicated that the amount of market penetration from Canadian steel was around 3 or 4 percent. What is up to now?

Mr. DEANER. Last year it was about 4 percent, and that is up from 2.4.

Senator METZENBAUM. Let me ask you this. I appreciate your statement, and we enjoy working with you. And we also understand that the American Iron and Steel Institute has in its membership both American and Canadian producers. Are those the only two countries that are in it?

Mr. DEANER. No. We also have producers from Mexico and a few others countries.

Senator METZENBAUM. Let me ask you, if you were an investor and you wanted to invest in the steel industry, where do you think the prospects would be better at the moment in view of economic conditions, in view of value of the dollar, the value of the Canadian dollar, the pension responsibilities on America as compared to Canada. Are there advantages which the Canadian industry would have, making it a more attractive investment opportunity than the U.S. steel industry?

Mr. DEANER. There is no question that the advantages are with the Canadians. Their track record of success is beyond reproach.

As you know, the American steel industry has lost some $12 billion over the last 5 years. Last year, we were profitable but not much, not nearly to the point that it is reported in the press. Total earnings for the steel industry last year were about $1 billion, and over half of that came from one-time things like the investment tax credit. The Canadian companies have, with few exceptions, been economically very successful.

Senator METZENBAUM. The Canadian industry claims that they are unofficially limiting their steel exports to the United States at the urging of the Commerce Department. Can you tell us what you know about that fact?

Mr. DEANER. Well, I do not know other than what I have read in the newspaper, when Mr. John Allan gave a press conference recently.

Senator METZENBAUM. Mr. John Allan?

Mr. DEANER. Mr. John Allan is the chairman of Stelco. And in that newspaper article, it indicated that they were targeting about 3 percent, which would be down from almost 4.

Senator METZENBAUM. I have already addressed myself to the exchange rate and the impact on cost of steel in Canada as compared to the United States. Do you have any suggestions as to how we might address this issue? Do you feel that in any way the FTA might somehow recognize the imbalance of the value of the dollar, one country as against another, and work that into the agreement?

Mr. DEANER. I think so.

Senator METZENBAUM. Have you had any discussions with Treasury or with Mr. Yeutter or anyone else speaking for the U.S. Government on that subject?

Mr. DEANER. Yes. We have met with both Secretary Baker and Mr. Yeutter and expressed our positions as we have told them to you today. And, of course, we do have the concern—our domestic members have the concern about the value of the dollar. An 80-cent dollar is difficult because our technology is quite similar. Our materials are quite similar. So much of what our two industries do are quite similar, and the 80-cent dollar makes it more difficult to compete.

Now, you know, going further—To be fair to both sides—the Canadians do buy iron ore and much of their coal in this country. So it is not all one-sided. They buy a lot of raw materials in this country.

Senator METZENBAUM. The Canadians are generally free traders when it comes to steel. Do you know of any examples of unfair trade practices by the Canadians? For instance, have the Canadians been producing above demand and unfairly marketing pipe and tubing?

Mr. DEANER. I really do not know the specifics of that.

Senator METZENBAUM. Mini-mills rely exclusively on electric arc furnaces, and an increasing number of integrated producers have put them to use. Don't your Canadian competitors benefit from electricity rates that are as much as one-third less than those paid by U.S. mills?

Mr. DEANER. Yes, I think that is true. And just another point, our integrated producers produce a lot of steel in electric furnaces, about 9 million tons a year. So while the mini-mills are normally associated with scrap users, actually the Specialty Steel Industry—which is here today—and the integrated producers use the bulk of scrap.

Senator METZENBAUM. Senator Rockefeller, do you have any questions?

Senator ROCKEFELLER. I do not. I have questions, but I want to hear as many people as possible, Senator.

Senator METZENBAUM. Fine. We may want to come back to some questions. Are you going to be able to remain with us, Mr. Deaner?

Mr. DEANER. Yes, sir. I would be pleased to.

[The prepared statement of Mr. Deaner follows:]

Written Statement of

Milton Deaner
President, American Iron and Steel Institute (AISI)

On Behalf of

Domestic Steel Producing Members

To The Senate Steel Caucus

On The U.S.-Canada Free Trade Agreement (FTA) And Its Impact On Domestic Steel Production

May 11, 1988

I am Milton Deaner, President of the American Iron and Steel Institute (AISI), and my written statement is on behalf of AISI's domestic member companies. You advised, Mr. Chairman, that your interest in our views on the U.S.-Canada Free Trade Agreement (FTA) is "to determine its impact on domestic steel production."

This is not an easy question to answer, because the quantity and mix of steel production have many determinants and it's not really possible to isolate the impact of the FTA as a discrete factor. I can tell you, however, that our domestic members have long believed that steel trade liberalization with any country is contrary to the goals of the President's Steel Program; they've been concerned about the level of steel imports from Canada since the inception of the President's Program; and it doesn't appear that the provisions of the FTA address this concern. Let me begin with a short history.

Before there was an FTA, the U.S. and Canada discussed the idea of sectoral free trade in steel. Our domestic members took the position then that steel should be totally left out of any sectoral free trade talks. Ultimately, the U.S. and Canada decided to pursue a general free trade agreement - and back in August of last year, while the FTA was still under negotiation - AISI submitted a statement to the Senate Finance Committee on behalf of domestic members. We said then that:

> "we strongly oppose steel trade liberalization talks with Canada (or with any other country) as long as the U.S. and world steel

crises continue unresolved...(and) we continue to oppose steel trade liberalization with Canada, as long as (1) the President's Steel Program is in effect, (2) the financial condition of domestic steel producers remains precarious and (3) there is a serious U.S.-Canadian dollar exchange rate imbalance."

Now that the FTA negotiations are complete, I can say that there is nothing in the agreement that's been negotiated that would cause our domestic members to change their position. They remain skeptical that trade liberalization with Canada is in their best interest, and they remain concerned about the level of steel imports from Canada - imports which increasingly are higher value finished steel products.

Imports of finished steel imports from Canada were 2.4 percent of the U.S. market in 1983, rose to about 3 percent in 1984 and 1985, increased to almost 3 1/2 percent in 1986 and were nearly 4 percent last year. From 1984 to 1987, when finished steel import market share from VRA countries declined 37 percent, finished steel import market share from Canada actually increased - 27 percent. (During this same period, U.S. imports of semifinished steel from Canada declined nearly 50 percent.)

With finished steel imports from Canada now accounting for 60 percent of total non-VRA imports, the Congressional Research Service recently concluded that "the rise in Canadian steel imports places in jeopardy the achievement of the target market shares of the President's Steel

Program...(and that Canada) is capturing more of the value added in the processing of finished steel products."

AISI's domestic members recognize that steel imports from Canada are not necessarily traded unfairly and that Canada's share of the U.S. steel market may not increase again in 1988. But, right now, all they have to go on is the performance record, in terms of import market share, of the last four years. They point out further that the President's Program aims to remedy market disruption and unfair trade through a system of bilateral restraint agreements with major steel exporting nations, and that the absence of such agreements with major exporting countries of necessity poses a problem.

It's a problem not only of maintaining the full effectiveness of the Program, but also of equity with those nations that have entered into VRAs. That's why the omnibus trade bill now includes the steel VRA "equity" provision sponsored by Senator Heinz. It gives USTR authority - authority that's completely discretionary I might add - to deal with such cases.

We all hope, Mr. Chairman, for a solution to the current steel trade policy friction between our two countries. Domestic steel producers in particular hope that the steel import figures for Canada will soon begin to demonstrate in an ongoing way, not just for an individual month or two, that a solution is being found. Until that point is reached, however, AISI's domestic member companies will continue to feel that steel imports from Canada are a very important problem in terms of the purpose and effectiveness of the President's Steel Program.

I said at the outset that domestic steel producers see nothing in the FTA that in and of itself addresses their concerns about high levels of steel imports from Canada. This raises a frequently asked question about the relationship of the FTA's provisions to the possibility of a U.S.-Canada VRA. Our understanding of this matter is quite clear: On the one hand, there's nothing in the FTA that would preclude Canada from entering into a steel VRA with the U.S. On the other hand, it's equally true that the government of Canada would have to be willing to enter into such an agreement - and, as far as we know, the Canadian government remains unwilling to do so.

U.S. producers readily acknowledge that, in two areas, the government of Canada and Canadian steel producers have made attempts to alleviate steel trade friction. Implementation of Canada's Steel Export Monitoring System is one such effort. It has helped clarify that third country transshipments aren't the cause of high levels of steel imports from Canada. (I might add that a recent analysis by the Congressional Research Service has helped clarify that mill-to-mill shipments aren't the problem, either.) A second effort by Canada has involved the Canadian government and producers working closely with the U.S. government and domestic producers to try to identify steel fraud. This is obviously helpful and appreciated on this side of the border -- but I think that both sides would probably agree that fraud affects only a small percentage of total U.S. steel imports from Canada.

Our domestic producers nevertheless support ongoing government-to-government talks to resolve U.S.-Canadian steel trade friction, and continue

to hope that Canadian steel trade policy can help maintain the integrity of the President's Program. In that regard, they appreciate the support of Congress and the Senate Steel Caucus in particular.

Beyond what I've already said, it's not likely that the FTA will have any immediate or substantial effect on the level of steel imports from Canada. I would, however, like to touch briefly on some of the domestic steel industry's concerns with FTA provisions.

First, the lack of any provision for dealing with the currency imbalance (the Canadian dollar is currently worth 81 cents) leaves Canadian steel firms, and Canadian producers of steel-containing products exported to the U.S., with a significant commercial advantage.

Second, the failure of the FTA to address the problem of Canadian provincial and federal government subsidy practices would appear to be incompatible with the goals of a free trade area.

Third, the proposed future development of a "substitute" dumping and subsidy trade law regime to replace the present U.S. and Canadian systems could lead to a serious weakening of U.S. trade laws, thereby harming U.S. producers of both steel and steel-containing products.

Fourth the proposed bi-national panel to replace judicial review of dumping and subsidy case findings in both countries could hurt U.S. petitioners by denying relief where it would otherwise be warranted.

And fifth, the provision that sets out the timing and procedure for elimination of steel tariffs allows duties in Canada to remain at a level twice that of the U.S. for the 10 year period of phase-out - and this benefit for Canadian producers comes at a time when Canada already has a substantial currency advantage.

To be fair, there is at least one FTA provision which our domestic producers believe is a very important plus: the proposed system of FTA rules to determining the country of origin of imports - all imports, including steel. This is a provision they wholeheartedly support, and would like to see become established world practice.

A further word on FTA implementing legislation. Here, our domestic members look forward to working both with Congress and with like-minded U.S. industries to ensure that the implementing language is directed as much as possible toward serving U.S. economic interests. In that connection, U.S. steel producers intend to submit ideas on such subjects as:

(1) the responsibility of the other party when the U.S. has VRAs with third countries;

(2) the consistency of a U.S.-Canada VRA with the FTA;

(3) our Administration's responsibility to consult with Congress and the private sector on a possible substitute dumping and subsidy law regime;

(4) the procedures for considering any proposed substitute system;

(5) the consistency with the FTA of applying the trade bill's steel VRA "melted and poured" provision to circumvention through Canada;

(6) a sense of the Congress that the FTA rule of origin for steel should be applied globally; and

(7) a provision for both countries to consult when multilateral lending institutions consider loans for projects in third countries involving products in excess capacity worldwide.

Between now and the end of the year, AISI's domestic member companies will periodically reevaluate their position on the FTA in light of future developments in two areas - the course of (1) U.S. implementing legislation and (2) the level of steel imports from Canada.

Thank you, Mr. Chairman. Our U.S. producers have appreciated the opportunity to present this statement.

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ALL PRODUCTS - CANADIAN IMPORTS AND IMPORT PENETRATION
1979-1987
(000 net tons)

TABLE 1

Year	Total Imports from Canada	Total US Apparent Supply	Total Canadian Import Penetration
1979	2,354	114,962	2.05%
1980	2,370	95,247	2.49%
1981	2,899	105,444	2.75%
1982	1,844	76,388	2.41%
1983	2,379	83,455	2.85%
1984	3,167	98,922	3.20%
1985	2,868	96,367	2.98%
1986	3,473	90,026	3.86%
1987	3,670	95,940	3.83%
2 mos. 1988	554	16,867	3.28%

Source: AISI Annual Statistical Reports, 1979-1986.
AISI Imports 3, 1987-1988;
Apparent Supply, 1987-1988.

FINISHED PRODUCTS - CANADIAN IMPORTS AND IMPORT PENETRATION
All Grades, Excludes Semifinished
1979-1987
(000 net tons)

TABLE 2

Year	Finished Products Imports from Canada	Finished Products - US Apparent Supply	Finished Products - Canadian Import Penetration
1979	2,302	112,341	2.05%
1980	2,267	93,350	2.43%
1981	2,320	102,532	2.26%
1982	1,658	74,751	2.22%
1983	1,940	81,732	2.37%
1984	2,902	96,174	3.02%
1985	2,798	92,642	3.02%
1986	2,990	86,515	3.46%
1987	3,534	92,137	3.84%
2 mos. 1988	541	16,047	3.37%

Source: AISI Annual Statistical Reports, 1979-1986.

AISI "Net Shipments of Steel Products"; AISI Imports 1 and 3;
AISI Exports 1 -- 1987-1988.

SEMIFINISHED STEEL IMPORTS - CANADA
1979-1987
(000 net tons)

TABLE 3

Year	Total Semifinished Imports	Canadian Semifinished Imports	Canadian % of Total Semifinished Imports
1979	344,693	52,056	15.10%
1980	155,343	102,640	66.07%
1981	790,062	579,267	73.32%
1982	716,588	185,922	25.95%
1983	822,483	438,330	53.29%
1984	1,515,837	265,797	17.53%
1985	2,440,368	70,223	2.88%
1986	2,084,096	213,171	10.23%
1987	2,282,654	135,645	5.94%
2 mos. 1988	559,941	13,525	2.42%

Source: AISI Annual Statistical Reports, 1979-1986.
AISI Imports 1 and 3, 1987-1988.

US-CANADA TRADE BALANCE IN STEEL
1979-1987
(000 net tons)

TABLE 4

Year	US Exports to Canada (steel mill products)	US Imports from Canada (steel mill products)	US-Canada Trade Balance (steel mill products)	Trade Balances: Carbon products only	Trade Balances: Alloy products only	Trade Balances: Stainless products only
1979	738	2,354	(1,616)	(1,599)	(49)	32
1980	477	2,370	(1,893)	(1,866)	(38)	11
1981	832	2,899	(2,067)	(2,016)	(67)	15
1982	348	1,844	(1,496)	(1,474)	(31)	9
1983	388	2,379	(1,991)	(2,001)	(4)	14
1984	345	3,167	(2,822)	(2,728)	(99)	4
1985	314	2,868	(2,554)	(2,445)	(119)	9
1986	216	3,203	(2,987)	(2,842)	(134)	(11)
1987	414	3,670	(3,256)	(3,143)	(87)	(26)
2 mos. '88	75	554	(479)	(456)	(19)	(4)

Source: AISI Annual Statistical Reports, 1979-1986.
AISI Imports 3; AISI Exports 2 -- 1987-1988.

Senator METZENBAUM. Mr. Robert Garvey is chairman of the National Steel Producers Association and chairman of North Star Steel. That is a plant from my own State in Youngstown. Mr. Garvey, please proceed.

STATEMENT OF ROBERT A. GARVEY, CHAIRMAN, NATIONAL STEEL PRODUCERS ASSOCIATION

Mr. GARVEY. Thank you, Mr. Chairman.

Mr. Chairman, I am presenting views on the U.S.-Canada Trade Agreement for the National Steel Producers Association, a trade group of nine U.S. steel companies. The phasing out of steel tariffs between the two countries under the agreement should be beneficial to U.S. steel producers, since U.S. steel import duties are——

Senator METZENBAUM. Mr. Garvey, if you read so fast, we are not going to be able to follow you. Why don't you lift up the mike a little bit higher and take it a little slower, and still confine yourself to 5 minutes.

Mr. GARVEY. I will start over with my important points.

The phasing out of steel tariffs between the two countries under the agreement should be beneficial to U.S. steel producers, since U.S. steel import duties are substantially below those of Canadian producers. Moreover, transshipped steel from other countries will not be accorded duty-free treatment when entering the United States from Canada unless further fabricated, which is also beneficial to U.S. producers. On balance, therefore, we do not oppose the successful conclusion of the proposed agreement, but we are in agreement with you about the issues of the relationships of the two currencies.

We would, however, urge that the two Governments address these two issues, outside of but simultaneously with the conclusion of the agreement. These are the relationship of the two currencies and the steel VRA's.

In light of our national concern over trade and current account deficits, we shall comment upon current account and merchandise trade balances of the United States and Canada, and also upon the steel trade balances between the two countries.

A serious deterioration has occurred since 1984 in the international economic position of the United States. During these 4 years, 1984 to 1987, the United States incurred a cumulative deficit of $538 billion on its balance of trade in merchandise. More significant, the United States during the same period incurred a cumulative deficit of $525 billion in its balance on current account.

The Canadian balance on current account and on merchandise trade in the 1980's is in sharp contrast to the U.S. record.

During 1982 to 1987, Canada achieved a cumulative surplus of $72 billion in its merchandise trade balance with all countries, in contrast to the U.S. merchandise trade deficit of $641 billion during that same period. Moreover, Canada was in near equilibrium in its balance on current account during 1982 to 1987, incurring a deficit of $7.4 billion in contrast to the U.S. current account deficit of $580 billion during that same period. Canada's overall balance on merchandise trade and on current account has been far stronger in the 1980's than that of the United States.

During the year 1982 to 1987, the United States incurred a cumulative deficit in its merchandise trade with Canada amounting to $80 billion, and a cumulative deficit on current account of $15 billion.

These data, viewed in the abstract, are less meaningful when considering the positive benefits over the long term which may accrue to both countries from a free trade agreement. But they are relevant to the relationship of the U.S. and the Canadian currencies which prevailed during much of this period.

The basic function of exchange rates is to balance accounts among nations. Under the current flexible exchange rate policy, to which both the United States and Canada adhere, exchange rate, at least in theory, should adjust to reflect changes in national accounts. The fact that the bilateral trade and current accounts of Canada and the United States did not produce a greater increase in the value of the Canadian dollar against the U.S. dollar during the 3 years 1984 to 1986 I think is worth further study. Clearly, high U.S. interest rates triggered by the massive U.S. fiscal deficit had something to do with this. Canada's domestic policies may have also contributed. The fundamentals between the two countries—trade and current account balances—have led some to conclude that the Canadian dollar during 1983 to 1986 was undervalued against the U.S. currency. In nominal, non-inflation adjusted terms, the Canadian dollar value has, on average, been about 27 percent below the value of the U.S. dollar since 1980. Under Morgan Guarantee's index of real effective exchange rates, the Canadian dollar in 1984 to 1986 was about 18 index points lower in value than the U.S. dollar, despite Canada's surplus with the United States of $45 billion on purchase trade and $15 billion on current account during those years.

In 1987, however, the Canada dollar and the U.S. dollar did move into parity in terms of real effective exchange rates. However, the very slow adjustment of the two currencies to a more realistic level in 1987, taking a full 3 years to reflect the fundamentals in the national accounts of the two countries is of concern. It demonstrates how national policies can impede the operation of the market forces adjustment mechanism in a flexible exchange rate system, causing trade in this case to flow in the wrong direction.

An effectively operating exchange rate relationship is the only basis upon which to build an enduring free trade relationship between the two countries. To date, the official position of both Governments is that exchange rate relationships should be considered only in a multilateral context.

Canada's favorable balance of trade in steel with the U.S. has more than doubled since 1982, both in tons and in dollars. In 1982, Canada had a net surplus in its steel trade with the United States approximating 1.5 million net tons. By 1987, this had increased to about 3.3 million tons. Canada's steel trade balance surplus expressed in U.S. dollars increased from about $400 million in 1982 to approximately $1 billion in 1987. The U.S. steel market is exceedingly important to Canada, accounting for as much as 25 percent of the entire Canadian steel industry's annual shipments.

Imports of steel products from Canada, comparable to those produced by several NSPA member companies, have also increased. In

1987, Canada accounted for 40.4 percent of total imports of hot rolled bars, compared to a range of 32 to 34 percent in the three prior years. In 1986 and 1987, Canada accounted for 31 to 32 percent of total cold finished bar imports, compared to 15 to 17 percent in the two prior years. Again, Canada accounted for 28 to 29 percent of imports of wire rod, compared to 24 to 25.9 percent in the two prior years.

Canada has not entered into a VRA agreement on steel with the United States, although all other countries with significant carbon steel exports to the United States signed such agreements.

The VRAs were bilaterally negotiated outside of the jurisdiction of the GATT. So were similar programs of several other countries, including the steel import and minimum price limitations of the European community.

All GATT member nations limiting steel imports take the position that their steel import limitation programs are consistent with GATT Article VI, and Article XIX.

However, the omission of Canada from participation in the steel VRAs appears to be inconsistent with GATT Article XIII, embodying the most favored nation trade principle of nondiscrimination among trading partners, a principle to which the United States has always subscribed.

Imports of VRA signatories have been reduced, and it is discriminatory treatment of those governments cooperating in the VRA program for the U.S. government to permit an increase in Canada's U.S. steel market share during this period.

In making this point, we do not wish to imply that Canadian steel producers are unfair traders. By and large, they are exceedingly competent, highly competitive, fair traders in steel.

But in a world in which most of the international trade in steel is distorted by government policies, some fair trading companies nevertheless are also signatories to the VRA program.

Accordingly, Canada should not be the only major steel trading nation exempted from the VRA provisions designed to affect the adjustment of the U.S. steel industry. It should participate in the VRA program.

In closing, I wish to state that the concept of a U.S.-Canada free trade agreement, a common market in North America from the Mexican border to the northernmost reaches of Canada, is appealing.

The National Steel Producers Association supports the proposed U.S.-Canada trade agreement, but we do not believe that such an agreement will succeed over the long term—we believe it will only succeed if it is based on a sound exchange rate relationship.

Therefore, we urge the Senate to ask the administration to explore with the Canadian officials the possible establishment of a bilateral consultations group, meeting regularly, to review the currency and other policy issues, in order to avoid impediments to enduring trade relationships between the two countries.

This is bound to occur eventually if such a relationship is to succeed, and it is better now than later.

Thank you.

Senator METZENBAUM. Do I understand your position to be that you support the FTA, but you feel that there ought to be a contin-

ued committee relationship having to do with the value of the dollar?

Mr. GARVEY. That is correct.

Senator METZENBAUM. And what if that does not move anywhere, but is a great discussion mechanism but does not achieve very much?

Mr. GARVEY. If it does not achieve it, then we think that the U.S. steel companies will be at a competitive disadvantage with the Canadians.

Senator METZENBAUM. And under those circumstances, once the United States has entered into the agreement, it would be very difficult to go back and make a non pro tunc entry going backwards.

What then happens to the American steel industry?

Mr. GARVEY. The American steel industry would have to retrench further, because part of the steel consumed in this country would be expanded to accommodate the Canadian imports.

Senator METZENBAUM. I am trying to understand your position.

You support the agreement with sort of an assumption that there will be some movement forward with respect to the disproportionate value of the dollar.

If there isn't that movement, and there is no assurances that there will be, then the American steel industry will suffer further. I have some difficulty in comprehending why, under those circumstances, you support the agreement, and why you would not be insisting on some understanding in advance on that subject, on the matter of the value of the dollar, as well as the participation in the VRA.

And does it not put you in the position of self-destruct?

Mr. GARVEY. Given that we cannot guarantee that there will be parity achieved through the agreement on the currencies, that is why we are also supporting the inclusion of the Canadians in a VRA agreement.

Senator METZENBAUM. Would that be a condition?

Mr. GARVEY. We believe that should be a condition, correct.

Senator METZENBAUM. A condition that their participation in the VRA, ought to be a condition of approval of the FTA, but absent that, would you still be in support of the FTA?

Mr. GARVEY. No, sir.

Senator METZENBAUM. Thank you.

[The prepared statement of Mr. Garvey follows:]

STATEMENT

OF

ROBERT A. GARVEY, PRESIDENT

NORTH STAR STEEL COMPANY

AND

CHAIRMAN, NATIONAL STEEL PRODUCERS ASSOCIATION

ON

PROPOSED FREE TRADE AGREEMENT

BETWEEN

THE U.S. AND CANADA

STEEL CAUCUS HEARING

UNITED STATES SENATE

MAY 11, 1988

Mr. Chairman, I am presenting views on the U.S./Canada trade agreement for the National Steel Producers Association, a trade group of nine U.S. steel companies. The phasing out of steel tariffs between the two countries under the agreement should be beneficial to U.S. steel producers, since U.S. steel import duties are substantially below those of Canadian producers. Moreover, transhipped steel from other countries will not be accorded duty free treatment when entering the U.S. from Canada, unless further fabricated, which is also beneficial to U.S. producers. On balance, therefore we do not oppose the successful conclusion of the proposed agreement.

We would, however, urge that the two governments address two important additional issues, outside of, but simultaneously with, the conclusion of the agreement. These concern the relationship of the two currencies, and the steel VRA's.

In light of our national concern over trade and current account deficits, we shall comment upon current account and merchandise trade balances, of the United States and Canada, and also upon the steel trade balances between the two countries.

As Table I (attached) indicates, a serious deterioration has occurred since 1984 in the international economic position of the United States. During the four years, 1984-1987, the U.S. incurred a cumulative deficit of $538 billion on its balance of trade in merchandise. More significant, the U.S., during this same period, incurred a cumulative deficit of $525.5 billion in its balance on current account. In a few years, the U.S. has shifted from a major creditor nation to a major debtor nation. In contrast, during the eight years, 1973 through 1980, the U.S. had a cumulative surplus of $4 billion in its balance on current account.

The Canadian balance on current account and on merchandise trade in the 1980s is in sharp contrast to the U.S. record. Table II below shows two major components of Canada's balances, 1981 through 1987:

Table II

SELECTED COMPONENTS OF CANADA'S BALANCE OF PAYMENTS, WITH ALL COUNTRIES 1981-1987*
(billions of U.S. dollars)

Year		Current Account	Merchandise
1982	2.4		14.4
1983	2.4		14.3
1984	2.6		16.0
1985	-0.9		12.4
1986	-6.7		7.5
1987	-7.2		7.7
Net Balance	-7.4		$72.3

*Source: U.S. Treasury Department

During 1982-1987, Canada achieved a cumulative surplus of $72.3 billion (U.S. dollars) in its merchandise trade balance with all countries, in contrast to the U.S. merchandise trade deficit of $641.7 billion during that same period. Moreover, Canada was in near equilibrium in its balance on current account, during 1982-1987, incurring a deficit of $7.4 billion (U.S.), in contrast to the U.S. current account deficit of $580.5 billion during that period. Canada's overall balance on merchandise trade and on current account has been far stronger in the 1980s than that of the United States.

In regard to the bilateral trade record of the two countries, Table III below shows current account and merchandise trade balances between the United States and Canada since 1982.

Table III

U.S. BALANCE WITH CANADA ON CURRENT ACCOUNT
AND ON MERCHANDISE TRADE, 1982-1987*
(billions of dollars)

Year	Current Account	Merchandise
1982	0.	-11.5
1983	-.1	-11.5
1984	-3.8	-14.6
1985	-8.6	-17.3
1986	-2.6	-13.3
1987	-.6	-11.9

*Source: Balance of Payments Data, Table 10, Survey of Current Business

During the years, 1982-1987, the United States incurred a cumulative deficit in its merchandise trade with Canada amounting to approximately $80.1 billion, and a cumulative deficit on current account of $15.7 billion.

These data, viewed in the abstract, are less meaningful when considering the positive benefits over the long term which may accrue to both countries from a free-trade agreement. But they are relevant to the relationship of the U.S. and Canadian currencies which prevailed during much of this period.

The basic function of exchange rates is to balance accounts among nations. Under the current flexible exchange rate policy, to which both the U.S. and Canada adhere, exchange rates, at least in theory, should adjust to reflect changes in national accounts. The fact that the bilateral trade and current accounts of Canada and the U.S. did not produce a greater increase in the value of the Canadian dollar against the U.S. dollar during the three years 1984 to 1986, is worth further study. Clearly, high U.S. interest rates triggered by the massive U.S. fiscal deficit had something to do with this. Canada's domestic policies may have also contributed. The fundamentals between the two countries, i.e., trade and current account balances, have led some to conclude that the Canadian dollar, during 1983-86, was undervalued against the U.S. currency. In nominal, non-inflation adjusted terms, the Canadian dollar value has, on average, been

about 27% below the value of the U.S. dollar since 1980. Under Morgan Guarantee's index (Table IV) of real effective exchange rates (real rates, derived by adjusting for inflation differentials against a basket of trade-weighted currencies) the Canadian dollar, in 1984-86, was substantially lower in value than the U.S. dollar, despite Canada's surplus with the U.S. of $45 billion on merchandise trade and $15 billion on current account during those years.

Table IV

INDEX OF REAL EFFECTIVE EXCHANGE RATES - U.S. AND CANADA*

Year	U.S.	Canada
1982	109.7	101.8
1983	114.9	105.6
1984	120.8	102.7
1985	123.3	99.0
1986	106.6	94.4
1987	96.5	96.6

*Source: Morgan Guarantee Trust Company.

During 1982 to 1986, Table IV shows that the real value of the Canadian dollar averaged about 12 index points below that of the U.S. dollar, despite a U.S. cumulative merchandise trade deficit of $68 billion with Canada, and a deficit of $15 billion on current account. In 1987, however, the Canadian dollar and U.S. dollar did move into parity, in terms of real effective exchange rates. However, the very slow adjustment of the two currencies to a more realistic level in 1987, taking a full three years to reflect the fundamentals in the national accounts of the two countries, is of concern. It demonstrates how national policies can impede the operation of the market forces adjustment mechanism in a flexible exchange rate system, causing trade, in this case, to flow in the wrong direction. Obviously, domestic policies in both countries will

affect the achievement of monetary equilibrium through market forces. But an effectively operating exchange rate relationship is the only basis upon which to build an enduring free trade relationship between the two countries. To date, the official position of both governments is that exchange rate relationships should be considered only in a multilateral context. Yet within its own trade union, the European Community has developed the European Monetary System (EMS). Accordingly, if the U.S. and Canada conclude a free trade agreement there should be no impedment to regular bilateral consultations on the effectiveness of the exchange rate relationship and on the domestic policies which affect that relationship.

Bilateral Trade in Steel

Major shifts have occurred in the balance of trade in steel between the United States and Canada:

TABLE V

U.S. BALANCE OF TRADE IN STEEL WITH CANADA*

Year	Thousands of Net Tons	U.S. Dollars (billions)
1982	-1,496	-$.402
1983	-1,991	-$.432
1984	-2,822	-$.859
1985	-2,553	-$.760
1986	-2,987	-$.899
1987	-3,255	-$1.061

*Source: Bureau of the Census - Highlights U.S. Export-Import Trade; U.S. Dept. of Commerce.

As Table V shows, Canada's favorable balance of trade in steel with the U.S. has more than doubled since 1982, both in tons and in dollars. In 1982, Canada had a net surplus in its steel trade with the U.S. approximating 1.5 million net tons. By 1987, this had increased to about 3.3 million tons. Canada's steel trade balance surplus expressed in U.S. dollars increased from about $400 million in 1982, to approximately $1 billion in 1987. The U.S. steel market is exceedingly important to Canada, accounting for as much as 25% of the entire Canadian steel industry's annual shipments.

Imports of steel products from Canada, comparable to those produced by several NSPA member companies, have also increased. In 1987, Canada accounted for 40.4% of total imports of hot rolled bars, compared to a range of 32%-34.4% in the three prior years. In 1986-87, Canada accounted for 31-32% of total cold finished bar imports, compared to 15%-17% in the two prior years. In 1986-87, Canada accounted for 28%-29.7% of imports of wire rod, compared to 24%-25.9% in the two prior years.

Canada has not entered into a VRA agreement on steel with the U.S. although all other countries with significant carbon steel exports to the U.S. have signed such agreements. The VRA's were bilaterally negotiated outside of the jurisdiction of the GATT. So were similar programs of several other countries, including the steel import and minimum price limitations of the European Community. All GATT member nations limiting steel imports take the position that their steel import limitation programs are consistent with GATT Article VI (antidumping and anti-subsidy provisions) and Article XIX (import limitations to remedy injury). However, the omission of Canada from participation in the steel VRA's appears to be inconsistent with GATT Article XIII embodying the most favored nation trade principle of non-discrimination among trading partners, a principle to which the U.S. has always subscribed. Imports of VRA signatories have been reduced and it is discriminatory treatment of those governments cooperating in the VRA program for the U.S. government to permit an increase in Canada's U.S. steel market share during this period. In making this point, we do not wish to imply that

Canadian steel producers are unfair traders. By and large, they are exceedingly competent, highly competitive, fair traders in steel. But in a world in which most of the international trade in steel is distorted by government policies, some fair trading countries, nonetheless, are also signatories to the VRA program. Accordingly, Canada should not be the only major steel trading nation exempted from the VRA provisions designed to effect the adjustment of the U.S. steel industry. It should participate in the VRA program.

In closing I wish to state that the concept of a U.S./Canada free trade agreement . . . a common market in North American from the Mexican border to the northernmost reaches of Canada . . . is appealing. The NSPA supports the proposed U.S./Canada trade agreement. But we do believe that such an agreement will succeed over the long term, only if it is based upon a sound exchange rate relationship. Therefore, we urge the Senate to ask the Administration to explore with Canadian officials the possible establishment of a bilateral consultations group meeting regularly to review currency and other policy issues in order to avoid impedments to an enduring free trade relationship between the two countries. This is bound to occur eventually, if such a relationship is to succeed, and better now than later.

Thank you Mr. Chairman.

Table I

SELECTED COMPONENTS OF U.S. BALANCE OF PAYMENTS, 1973-1987*
(billions of dollars)

Year	Current Account[1]	Merchandise[2]	All Goods and Services[3]
1973	7.1	.9	11.0
1974	2.1	-5.3	9.3
1975	18.3	9.0	22.9
1976	4.4	-9.3	9.4
1977	-14.1	-30.9	-9.5
1978	-14.8	-33.8	-9.7
1979	-.5	-27.3	5.1
1980	1.5	-25.3	9.5
1981	4.5	-27.9	14.3
1982	-8.7	-36.4	.3
1983	-46.3	-67.1	-36.8
1984	-107.0	-112.5	-94.8
1985	-116.4	-122.2	-101.1
1986	-141.4	-144.3	-125.7
1987	-160.7	-159.2	-147.2

*Source: U.S. Department of Commerce, Bureau of Economic Analysis "Survey of Current Business".

1/ "Current Account" refers to goods, services, and transfer payments.

2/ "Merchandise" refers to products, whether agriculture or manufactured.

3/ "All Goods and Services" refers to merchandise and services, including travel expenditures, transportation, fees, and return on assets abroad.

Senator METZENBAUM. Can I hear from Mr. C. Philip Weigel, a member of the executive committee, Specialty Steel Industry of the United States, and president and chief executive officer of Latrobe Steel.

Happy to have you with us, sir.

STATEMENT OF C. PHILIP WEIGEL, MEMBER, EXECUTIVE COMMITTEE, SPECIALTY STEEL INDUSTRY OF THE UNITED STATES, AND PRESIDENT AND CHIEF EXECUTIVE OFFICER, LATROBE STEEL CO., ACCOMPANIED BY DAVID HARTQUIST AND ROBERT MEUSER

Mr. WEIGEL. Thank you, Mr. Chairman.

Senator METZENBAUM. I will have additional questions, but I think we will hear from the balance of our witnesses before going to further questions.

Please proceed.

Mr. WEIGEL. Mr. Chairman, and Members of the Senate Steel Caucus, good morning. I am accompanied by Mr. David Hartquist, and Mr. Robert Meuser.

The Specialty Steel Industry of the United States is a nonprofit trade association representing 14 producers of stainless, electrical and alloy tool steel.

The domestic specialty steel industry is a modern, cost-competitive, high technology sector of the U.S. steel industry.

We appreciate this opportunity to testify regarding the Canada-U.S. free trade agreement.

When the FTA negotiations commenced, the specialty steel industry expressed three main reservations concerning free trade in specialty steel between the United States and Canada.

One concern of the specialty steel industry has been Canada's refusal to enter into a VRA governing steel trade. Although a major supplier of steel to the U.S. market, Canada refused to enter into a VRA with the United States.

We strongly disagree in principle with Canada's position. In looking at the history of imports of finished specialty steel products from Canada over the last few years, we find that they have been relatively stable.

We believe that this has been due primarily to the specialty steel section 201 import restraint program and the strong competitiveness of our industry.

However, we are concerned that our industry could be at risk when the restraint program expires on September 30, 1989.

If the President's separate steel import relief program is extended, we would strongly support the negotiation of a VRA with Canada, and the inclusion of all finished specialty steel products in that VRA.

After careful consideration, our concern about the lack of a VRA with Canada is not sufficient to compel the specialty steel industry to oppose the FTA.

Most of the recent growth in imports from Canada has been in the semi-finished stainless steel category. This material has been brought in primarily by our member companies.

Our view, therefore, is based on the current relative stability of finished specialty steel imports, and the understanding that a VRA could still be negotiated in the future, even under an FTA regime.

Senator METZENBAUM. I asked the question of the previous speaker as to whether or not you would look to a VRA agreement prior to Senate acting in connection with the FTA, or whether you would be willing to assume that that might be obtained at a later date?

Mr. WEIGEL. I guess we are taking the position that we assume that that would happen at a later date.

Senator METZENBAUM. And if it did not, would it do much harm to the specialty steel industry?

Mr. WEIGEL. As shown in my testimony that will come later, we are competing with the Canadian steel industry today, and we feel that the balance of trade is reasonably satisfactory in the specialty steel industry sector.

The second concern of the specialty steel industry was the worsening balance of bilateral trade in specialty steel as the two governments entered into FTA negotiations.

As a general proposition, the Canadian tariffs on specialty steel historically have been higher than those of the United States. Despite this imbalance in tariffs, bilateral steel trade, specialty steel trade, was in rough parity, although usually favoring Canada from 1982 through 1985.

The history of the U.S.-Canada trading relationship in specialty steel thus demonstrates that the U.S. industry can compete in Canada, even in the face of significant tariffs and an overvalued dollar.

This situation worsened rapidly in 1986 and 1987. The specialty steel trade balance grew to more than 18,000 tons in 1986, and 29,000 tons in 1987, largely due to the increase in imports of semi-finished stainless steel by our member companies.

Nevertheless, the promise of the elimination of historically higher Canadian tariffs, and the gradual realignment of the U.S.-Canada exchange rate suggest that U.S. producers will have a solid opportunity to restore that rough trade balance under the FTA.

U.S. specialty steel producers, in fact, look forward to seeking to penetrate the Canadian market under a free trade regime.

Finally, the specialty steel industry also was concerned that third-country producers of specialty steel would exploit a U.S.-Canada free trade arrangement, one, by transshipping unfairly priced products through Canada, thereby avoiding all tariffs, as well as existing restraint agreements; or two, by selling unfairly priced, that is dumped or subsidized products, to Canadian fabricators, who in turn would sell their fabricated products, duty-free, in the U.S. market, thereby harming U.S. producers of fabricated products and their suppliers, domestic specialty steel producers.

For example, the specialty steel industry believes that in order to circumvent the stainless steel wire rod quotas, third country producers ship stainless steel wire rod into Canada where it is then cold drawn into stainless steel wire.

The specialty steel industry feared that the elimination of U.S. tariffs on Canadian specialty steel would further increase the incentive for foreign producers to engage in such practices.

These concerns largely have been allayed by the FTA. The FTA rules of origin would require processing in Canada to transform basic steel shapes imported from third countries into steel fabrications before duty-free status is accorded.

Although the FTA fails to address the risk of downstream effects of U.S. steel fabricators, it does appear to have responded adequately to the industry concerns regarding direct transshipment effects.

Our final concern arises out of the binational dispute resolution mechanism established for anti-dumping and countervailing duty actions. The specialty steel industry considers such a mechanism bad policy, and a bad precedent.

The United States must retain control of its unfair trade statutes if the relief intended by those laws is to continue to be available to injured U.S. industries.

Nevertheless, this concern is not sufficient to cause the specialty steel industry to oppose the FTA. For these reasons, the specialty steel industry of the United States does not object to the implementation of the Canada-U.S. free trade agreement.

The FTA appears to have responded to the concerns of the U.S. industry expressed during the negotiations.

Thank you for your attention. I will be happy to respond to any questions that the caucus might have.

Senator METZENBAUM. Thank you very much.

Senator ROCKEFELLER. Can I ask one question?

Senator METZENBAUM. Surely.

Senator ROCKEFELLER. On this transshipment concern of yours, what countries appear to be taking advantage of that? Do they include Korea or Taiwan, which of course are covered by VRA?

Mr. WEIGEL. Yes, we thought that Taiwan was one of the principal countries involved in this transshipment.

Senator ROCKEFELLER. Anybody else?

Mr. WEIGEL. Not that I can think of.

Senator ROCKEFELLER. Thank you.

Senator METZENBAUM. Thank you very much.

Mr. WEIGEL. Excuse me, Sweden, also, was another concern.

Senator METZENBAUM. Thank you, Mr. Weigel. We will come back with some questions.

[The prepared statement of Mr. Weigel follows:]

BEFORE THE SENATE STEEL CAUCUS

CANADA-U.S. FREE TRADE AGREEMENT

WRITTEN STATEMENT OF THE SPECIALTY STEEL INDUSTRY OF THE UNITED STATES

SUPPLEMENTING THE TESTIMONY
OF
C. PHILIP WEIGEL,
PRESIDENT AND CHIEF EXECUTIVE OFFICER,
LATROBE STEEL COMPANY

DAVID A. HARTQUIST
ROBERT L. MEUSER

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Counsel for the Specialty Steel Industry
of the United States

May 11, 1988

BEFORE THE SENATE STEEL CAUCUS

WRITTEN STATEMENT OF THE
SPECIALTY STEEL INDUSTRY OF THE UNITED STATES

Mr. Chairman and Members of the Senate Steel Caucus:

Good Morning. My name is C. Philip Weigel. I am President and Chief Executive Officer of Latrobe Steel Company of Latrobe, Pennsylvania. As a member of the organization's Executive Committee, I am appearing here today on behalf of the Specialty Steel Industry of the United States. The Specialty Steel Industry is a trade association representing U.S. producers of stainless, alloy tool, and electrical steel.

We appreciate this opportunity to testify regarding the Canada-U.S. Free Trade Agreement ("FTA"). The FTA is a remarkable international trade agreement that presents opportunities and promise, as well as risks and threats, to the U.S. specialty steel industry.

When the United States first entered into negotiations toward the FTA, we expressed serious reservations about such an agreement's implications for our industry. Those reservations included: (1) the refusal of Canada to enter into a voluntary restraint arrangement ("VRA") governing steel trade under the President's Steel Import Relief Program and the Steel Import Stabilization Act; (2) the risk of transshipment of steel products through Canada from countries participating in the VRA program; and (3) the deteriorating balance of specialty steel trade between the United States and Canada.

The FTA has not resolved these concerns completely. It has, however, addressed them to the satisfaction of the industry. Although Canada's lack of cooperation in the Steel Import Relief Program continues to prompt reservations within the industry, the FTA on its merits alone has incorporated sufficient protections to prevent specialty steel trade under the FTA from undermining the relief intended by the Steel Import Relief Program and the Steel Import Stabilization Act.

Moreover, the concept of bilateral free trade in specialty steel holds out some promise given the high degree of competitiveness of the U.S. specialty steel industry and the generally higher tariffs confronted by U.S. producers attempting to export specialty steel to Canada. Finally, two of our member companies -- AL-Tech Specialty Steel Corporation and Slater Steels Corporation -- are Canadian-owned.

For these reasons, the Specialty Steel Industry of the United States has determined to accept without objection the implementation of the FTA. We welcome the opportunity to compete in the Canadian market, and will utilize all mechanisms available to ensure that Canada does not unfairly abuse its special position vis-s-vis the U.S. market in specialty steel trade.

Description of the Industry

The Specialty Steel Industry of the United States is a nonprofit trade association representing 14 producers of stainless, electrical and alloy tool steel. A list of the member companies of the Specialty Steel Industry of the United States is attached as Appendix A to this document. The domestic specialty steel industry is a modern, cost-competitive, high technology sector of the U.S. steel industry. Its products are essential to America's highly developed economy as well as critical to the national defense. The industry's commitment to innovation and modernization has been noted repeatedly by analysts both inside and outside the U.S. government.

To maintain its vitality and technological edge, however, the industry has been forced to seek relief from unfairly traded imports. Import relief has been accorded the industry under a variety of statutes, confirming the import sensitivity of the industry, its role in the economy and in national security, and the validity of its allegations of unfair trade. Indeed, in providing import relief in 1983, the President concluded that this "relief is consistent with our national economic interest and is necessitated by the pervasive nature of unfair trading practices in specialty steel." 48 Fed. Reg. 31,777 (1983).

The effectiveness of import relief has been limited, however, by a variety of innovative and sometimes unlawful vehicles designed by foreign producers to circumvent the industry's import relief program. In an effort to ensure the continued effectiveness of these programs and to ensure the continued competitiveness of this essential industry, the Specialty Steel Industry set forth its specific concerns regarding the inclusion of specialty steel products within the scope of the U.S.-Canada free trade negotiations early in the negotiating process.

Concerns of the Specialty Steel Industry and How the FTA Resolved Them

When the FTA negotiations commenced, the Specialty Steel Industry expressed its reservations concerning free trade in specialty steel between the United States and Canada under the prevailing circumstances of the international specialty steel market. Although these reservations have not been dispelled completely by the FTA, the FTA either responds to the concerns or at least contains adequate safeguards. The Specialty Steel Industry accordingly deems the FTA satisfactory and does not object to its implementation.

A. Refusal of Canada to Enter Into a VRA

One concern of the Specialty Steel Industry has been Canada's refusal to enter into a VRA governing steel trade. Although a major supplier of steel to the U.S. market, Canada declined to enter into a VRA with the United States. Its refusal must be viewed in context: nearly every other significant steel exporting country willingly cooperated with the President's Steel Import Relief Program and the Steel Import Stabilization Act. Canada thus failed to assist in the revitalization of the U.S. steel industry even though it was a major beneficiary of participation in the U.S. steel market. This example of noncooperation engendered concern within the specialty steel industry over the practical consequences of bilateral free trade in specialty steel.

This concern has been mitigated by the fact that, unlike the situation with carbon and alloy steel, imports of finished specialty steel products from Canada have

been relatively stable over the last several years. As shown in Table 1, total imports of finished specialty steel products have generally ranged between 21,000 and 23,000 tons from 1982 through 1987, except in 1983 and 1985, when lower levels were achieved.

We believe that this stability in finished products imports has been due primarily to the strong competitiveness of our industry and the specialty steel import restraint program established under section 201 of our trade laws by President Reagan in 1983. The program was extended by the President last year to September 30, 1989. Orderly Marketing Agreements have been negotiated between the U.S. and Canada as part of the implementation of the global restraint program.

However, we are very concerned about the period beyond September 30, 1989. The current specialty steel import restraint program cannot be extended under law, and the U.S. industry therefore could be at risk. As also shown in Table 1, it is interesting to note that imports of semi-finished specialty steel, which are not included in the current restraints, have surged dramatically during this period. Most of the imports of semi-finished steel were brought in by our own member companies. If the President's steel VRA program is extended beyond September 30, 1989, we would strongly support the negotiation of a VRA with Canada and the inclusion of all finished specialty steel products in the VRA. It is our understanding that the FTA would not preclude the negotiation of a VRA covering all steel products.

After careful consideration, our concern about the lack of a VRA with Canada is not sufficient to compel the Specialty Steel Industry to oppose the FTA. This view is based on the current relative stability of finished specialty steel imports and the understanding that a VRA could still be negotiated in the future, even under an FTA regime.

B. **Balance of Specialty Steel Trade**

The second concern of the Specialty Steel Industry was the worsening balance of bilateral trade in specialty steel as the two governments entered into FTA negotiations. The elimination of historically high Canadian tariffs, and the realignment of the U.S. dollar, should permit the U.S. specialty steel industry to take advantage of opportunities to export to the Canadian market under the FTA.

As a general proposition, Canadian tariffs on specialty steel historically have been higher than those of the United States. Both now range between a lower terminus of less than five percent ad valorem up to a peak of 12.5 percent ad valorem. Canadian tariffs, however, are largely at the higher end of the scale (ten percent of ad valorem and above). In contrast, U.S. tariffs generally range downward from ten percent. Appendix B contains copies of the relevant U.S. and Canadian FTA tariff schedules.

Despite this imbalance in tariffs, a comparison of Tables 1 and 2 reveals that from 1982 through 1985, U.S. specialty steel trade was not as sharply imbalanced as subsequently during 1986 and 1987. Canada enjoyed an overall surplus in tonnage terms in each year except 1983, when the U.S. reversed its position to achieve a surplus. The Canadian surplus in 1985 also amounted to less than 1,000 tons. In certain categories (such as stainless steel sheet and strip), the United States achieved substantial surpluses through much of the period covered. The history of the U.S.-Canada trading relationship in specialty steel thus demonstrates that the U.S. industry can compete even in the face of significant tariffs and an overvalued dollar.

This situation worsened rapidly in 1986 and 1987, however. The tonnage trade imbalance grew to more than 18,000 tons in 1986 and 29,000 tons in 1987. As explained above, these increases can be attributed largely to an increase in imports of semi-finished stainless steel by member companies of the Specialty Steel Industry. Nevertheless, U.S. exports of specialty steel fell from 17,750 tons in 1985 to 10,401 tons in 1986, before rebounding to 17,948 tons in 1987. These trends engendered reservations

throughout the U.S. industry as the two governments began negotiations, particularly given that U.S.-Canada bilateral steel trade was not covered by the VRA program.

Nevertheless, the promise of the elimination of historically higher Canadian tariffs, and the gradual realignment of the U.S.-Canada exchange rate, suggest that U.S. producers will have a solid opportunity to restore that rough balance under the FTA. U.S. producers are highly competitive and are making substantial efforts to expand their exports. The FTA's elimination of generally higher Canadian tariffs could facilitate U.S. exports, and the Specialty Steel Industry looks forward to seeking to penetrate the Canadian market under a free trade regime.

C. Risk Transshipments of Unfairly Traded Foreign Specialty Steel into the United States

The Specialty Steel Industry also was concerned that foreign producers of specialty steel would exploit a U.S.-Canada free trade arrangement through transshipments. These transshipments can occur either by: (1) transshipping unfairly priced products through Canada, thereby avoiding all tariffs as well as existing restraint arrangements; or (2) selling unfairly priced products to Canadian fabricators, who in turn would sell their fabricated products -- duty free -- in the U.S. market, thereby harming U.S. producers of fabricated products and their suppliers (domestic specialty steel producers).

Canada had already provided indications that it would be a willing party to these types of practices when the Specialty Steel Industry's reservations were first expressed. For example, the Specialty Steel Industry believes that Canada was used to circumvent VRA and section 201 import relief coverage in the case of stainless steel wire. Stainless steel wire rod was covered by the section 201 (now section 203) import relief program starting in 1982, while the 1984 VRA program encompassed stainless steel wire. The Specialty Steel Industry's belief is that stainless steel wire rod was imported into Canada, where it was then cold-drawn into stainless steel wire and re-exported to the United States. The relatively minimal redrawing process provided the appearance of

substantial transformation of the wire rod in Canada, while effectively circumventing the VRA/section 201 restraints on wire rod and wire from the original exporting country. Canada's status outside of the VRA program created the incentive for such transshipment. The significant increase over prior year levels in U.S. stainless steel wire imports from Canada during 1986 and 1987, as shown in Table 1, provides some confirmation of this belief. The Specialty Steel Industry feared that the reduction or elimination of U.S. tariffs on Canadian specialty steel would further increase the incentives for foreign producers to engage in such practices.

Moreover, the domestic industry was concerned about the potential increase in specialty steel imports which could result from the elimination of U.S. tariffs on Canadian goods fabricated from specialty steel. Specifically, the industry feared a scenario whereby third country specialty steel was sold to Canadian fabricators at dumped prices, and those fabricators in turn sold their products in the U.S. market -- duty free -- at prices reflecting their unfairly low material costs. The impact on the U.S. industry thus would be two-fold: domestic fabricators of specialty steel products would lose substantial sales and their suppliers, U.S. specialty steel producers, would find themselves deprived of customers. Indeed, the industry's U.S. customers might be driven to purchase cheap foreign steel in order to reduce material costs so as to meet the Canadian competition. This result would mean further lost sales to the domestic industry.

These concerns largely have been allayed by the FTA. The FTA rules of origin will require processing in Canada that transforms basic steel shapes imported from third countries into steel fabrications. Processing from stainless steel rod to stainless steel wire, for example, should not be sufficient under the terms of the FTA to render the stainless steel wire eligible for duty-free treatment as a product of Canada. Although the FTA does not address the risk of downstream effects on U.S. steel

fabricators, therefore, it appears to have responded adequately to industry concerns regarding direct transshipment effects.

D. Binational Dispute Resolution Mechanism

The final text of the FTA has raised a new concern for the Specialty Steel Industry. The FTA will create a binational dispute resolution mechanism for antidumping and countervailing duty actions. In the Specialty Steel Industry's view, this approach to dispute resolution is bad policy and a bad precedent.

Under the FTA, a panel comprised of Americans and Canadians will possess exclusive authority to review appeals from final agency determinations in antidumping and countervailing duty proceedings. The panel will have binding power to direct modifications in agency decisions. Although the FTA instructs the panels to apply appropriate domestic law, it also directs the panel to maintain consistency with the objectives of the FTA and the General Agreement on Tariffs and Trade ("GATT").

Numerous commentators have questioned the constitutionality of this mechanism. Our primary concern, however, is more practical. The binational panel will remove the administration of the antidumping and countervailing duty laws, at least with respect to imports from Canada, out of the exclusive control of the U.S. government. That result in turn raises the specter of the denial of the kind or extent of relief intended by Congress for domestic industries injured by unfair trade practices.

In our view, therefore, the binational panel mechanism constitutes an incorrect policy for the United States in the administration of the international trade laws. Moreover, it sets an unfortunate precedent for future international trade negotiations. If followed, such a mechanism could conceivably undermine the effectiveness of these laws.

Nevertheless, the Specialty Steel Industry's reservations about the binational dispute resolution mechanism are not sufficient to cause its opposition to the FTA. The mechanism is temporary in any event, and there does not appear to be a present risk of

its transformation into a multilateral mechanism of general application. Finally, the Specialty Steel Industry hopes that the FTA's direction to apply U.S. law, combined with vigilant private and Congressional oversight, will prevent the panel from having a deleterious impact on the availability of relief under the unfair trade laws.

Conclusion

For these reasons, the Specialty Steel Industry of the United States does not object to the implementation of the Canada-U.S. Free Trade Agreement. The FTA appears to have responded to the concerns of the U.S. industry expressed during the negotiations, and also contains sufficient safeguards to allow the industry to seek remedies should the FTA yield trade effects that prove injurious to the domestic industry.

Thank you. I will be happy now to respond to any questions that members of the Caucus might have.

TABLE 1

U.S. Imports of Specialty Steel Products from Canada
(tons)

	1982	1983	1984	1985	1986	1987	Jan.-Feb. 1987	Jan.-Feb. 1988
Stainless Steel								
Sheet/Strip	5,340	4,133	4,385	2,437	4,115	4,893	807	743
Plate	432	27	37	33	26	90	5	19
Bar	408	450	1,125	1,035	1,044	1,309	392	305
Rod	26	4	19	0	0	0	0	0
Wire	1,179	1,096	1,609	1,480	2,483	2,044	370	339
Tool Steel	1,439	816	2,706	1,582	1,594	1,889	430	969
Electrical Steel	13,780	10,469	11,136	11,378	12,638	11,631	1,728	2,022
Total Finished Products	22,604	16,995	21,017	17,945	21,900	21,856	3,732	4,397
Semi-Finished Stainless	1,732	364	806	645	6,808	25,146	3,868	3,949
TOTAL	24,336	17,359	21,823	18,590	28,708	47,002	7,600	8,346

TABLE 2

U.S. Exports of Specialty Steel Products to Canada
(tons)

	1982	1983	1984	1985	1986	1987	Jan.-Feb. 1987	Jan.-Feb. 1988
Stainless Steel								
Sheet/Strip	12,141	13,268	7,161	9,862	3,662	4,859	1,022	1,064
Plate	1,189	2,341	1,313	1,049	635	2,615	354	690
Bar	1,764	2,566	2,152	2,217	1,387	1,311	192	163
Rod	371	458	583	177	80	67	15	32
Wire	460	745	654	429	470	555	63	105
Tool Steel	942	1,340	708	959	728	1,564	194	260
Electrical Steel	2,443	666	1,128	2,307	3,329	6,797	920	706
Total Finished Products	19,310	21,384	13,699	17,000	10,291	17,768	2,760	3,020
Semi-Finished Stainless	252	388	562	750	110	180	14	172
TOTAL	19,562	21,772	14,261	17,750	10,401	17,948	2,774	3,192

APPENDIX A

MEMBERS OF THE SPECIALTY STEEL INDUSTRY OF THE UNITED STATES

Allegheny Ludlum Corporation
Pittsburgh, Pennsylvania

AL Tech Specialty Steel Corporation
Dunkirk, New York

ARMCO Specialty Steel Division
Butler, Pennsylvania

Carpenter Technology Corporation
Reading, Pennsylvania

Crucible Specialty Metals Division
Crucible Materials Corporation
Syracuse, New Yok

Cyclops Corporation
Pittsburgh, Pennsylvania

Eastmet Corporation
Baltimore, Maryland

Jessop Steel Company
Washington, Pennsylvania

J&L Specialty Products Company
Pittsburgh, Pennsylvania

Latrobe Steel Company
Latrobe, Pennsylvania

Slater Steels Corporation
Fort Wayne Specialty Alloy Division
Fort Wayne, Indiana

Teledyne Vasco
Latrobe, Pennsylvania

Washington Steel Corporation
Washington, Pennsylvania

SCHEDULE OF THE UNITED STATES OF AMERICA

APPENDIX B

Item	Article description	Base rate	Staging Category
7217 (con.)	Wire of iron or nonalloy steel (con.):		
	Containing by weight less than 0.25, etc. (con.):		
7217.19	Other:		
7217.19.10	Plastic coated	0.9%	C
7217.19.50	Other	5.3%	C
	Containing by weight 0.25 percent or more but less than 0.6 percent of carbon:		
7217.21	Not plated or coated, whether or not polished:		
7217.21.10	Flat wire	5.2%	C
7217.21.30	Round wire	5.3%	C
7217.21.50	Other	5.5%	C
7217.22	Plated or coated with zinc:		
7217.22.10	Round wire	5.3%	C
7217.22.50	Other	5.2%	C
7217.23	Plated or coated with other base metals:		
7217.23.10	Round wire	5.3%	C
7217.23.50	Other	5.2%	C
7217.29	Other:		
7217.29.10	Plastic coated	0.9%	C
7217.29.50	Other	5.3%	C
	Containing by weight 0.6 percent or more of carbon:		
7217.31	Not plated or coated, whether or not polished:		
7217.31.10	Flat wire	5.2%	C
7217.31.30	Round wire	5.3%	C
7217.31.50	Other	5.5%	C
7217.32	Plated or coated with zinc:		
7217.32.10	Round wire	5.3%	C
7217.32.50	Other	5.2%	C
7217.33	Plated or coated with other base metals:		
7217.33.10	Round wire	5.3%	C
7217.33.50	Other	5.2%	C
7217.39	Other:		
7217.39.10	Plastic coated	0.9%	C
7217.39.50	Other	5.3%	C
	III. STAINLESS STEEL		
7218	Stainless steel in ingots or other primary forms; semifinished products of stainless steel:		
7218.10.00	Ingots and other primary forms	5.2%	C
7218.90.00	Other	5.2%	C
7219	Flat-rolled products of stainless steel, of a width of 600 mm or more:		
	Not further worked than hot-rolled, in coils:		
7219.11.00	Of a thickness exceeding 10 mm	10.1%	C
7219.12.00	Of a thickness of 4.75 mm or more but not exceeding 10 mm	10.1%	C
7219.13.00	Of a thickness of 3 mm or more but less than 4.75 mm	10.1%	C
7219.14.00	Of a thickness of less than 3 mm	10.1%	C
	Not further worked than hot-rolled, not in coils:		
7219.21.00	Of a thickness exceeding 10 mm	9.6%	C
7219.22.00	Of a thickness of 4.75 mm or more but not exceeding 10 mm	9.6%	C
7219.23.00	Of a thickness of 3 mm or more but less than 4.75 mm	10.1%	C
7219.24.00	Of a thickness of less than 3 mm	10.1%	C

SCHEDULE OF THE UNITED STATES OF AMERICA

Item	Article description	Base rate	Staging Category
7219 (con.)	Flat-rolled products of stainless steel, etc. (con.):		
	Not further worked than cold-rolled (cold-reduced):		
7219.31.00	Of a thickness of 4.75 mm or more	10.1%	C
7219.32.00	Of a thickness of 3 mm or more but less than 4.75 mm	10.1%	C
7219.33.00	Of a thickness exceeding 1 mm but less than 3 mm	10.1%	C
7219.34.00	Of a thickness of 0.5 mm or more but not exceeding 1 mm	10.1%	C
7219.35.00	Of a thickness of less than 0.5 mm	10.1%	C
7219.90.00	Other	5.9%	C
7220	Flat-rolled products of stainless steel, of a width of less than 600 mm:		
	Not further worked than hot-rolled:		
7220.11.00	Of a thickness of 4.75 mm or more	10.6%	C
7220.12	Of a thickness of less than 4.75 mm:		
7220.12.10	Of a width of 300 mm or more	10.1%	C
7220.12.50	Of a width of less than 300 mm	11.6%	C
7220.20	Not further worked than cold-rolled (cold-reduced):		
7220.20.10	Of a width of 300 mm or more	10.1%	C
	Of a width of less than 300 mm:		
7220.20.60	Of a thickness not exceeding 1.25 mm	11.6%	C
7220.20.70	Of a thickness exceeding 0.25 mm but not exceeding 1.25 mm	10.6%	C
	Of a thickness not exceeding 0.25 mm:		
7220.20.80	Razor blade steel	5.2%	C
7220.20.90	Other	8.1%	C
7220.90.00	Other	5.7%	C
7221.00.00	Bars and rods, hot-rolled, in irregularly wound coils, of stainless steel	4.7%	C
7222	Other bars and rods of stainless steel; angles, shapes and sections of stainless steel:		
7222.10.00	Bars and rods, not further worked than hot-rolled, hot-drawn or extruded	10.6%	C
7222.20.00	Bars and rods, not further worked than cold-formed or cold-finished	10.6%	C
7222.30.00	Other bars and rods	10.6%	C
7222.40	Angles, shapes and sections:		
7222.40.30	Hot-rolled, not drilled, not punched and not otherwise advanced	2.1%	C
7222.40.60	Other	5.3%	C
7223.00	Wire of stainless steel:		
7223.00.10	Round wire	9.1%	C
7223.00.50	Flat wire	3.3%	C
7223.00.90	Other	6.3%	C

SCHEDULE OF THE UNITED STATES OF AMERICA

Item	Article description	Base rate	Staging Category
	IV. OTHER ALLOY STEEL; HOLLOW DRILL BARS AND RODS, OF ALLOY OR NONALLOY STEEL		
7224	Other alloy steel in ingots or other primary forms; semifinished products of other alloy steel:		
7224.10.00	Ingots and other primary forms	5.1%	C
7224.90.00	Other	5.1%	C
7225	Flat-rolled products of other alloy steel, of a width of 600 mm or more:		
7225.10.00	Of silicon electrical steel	5.8%	C
7225.20.00	Of high-speed steel	10.5%	C
7225.30	Other, not further worked than hot-rolled, in coils:		
7225.30.10	Of a thickness of 4.75 mm or more:		
7225.30.30	Of tool steel (other than high-speed steel)	9.6%	C
	Other	3.8%	C
7225.30.50	Of a thickness of less than 4.75 mm:		
7225.30.70	Of tool steel (other than high-speed steel)	9.6%	C
7225.40	Other	9.5%	C
	Other, not further worked than hot-rolled, not in coils:		
7225.40.10	Of a thickness of 4.75 mm or more:		
7225.40.30	Of tool steel (other than high-speed steel)	9.6%	C
	Other	3.8%	C
7225.40.50	Of a thickness of less than 4.75 mm:		
7225.40.70	Of tool steel (other than high-speed steel)	9.6%	C
7225.50	Other	9.5%	C
	Other, not further worked than cold-rolled (cold-reduced):		
7225.50.10	Of tool steel (other than high-speed steel)	10.1%	C
	Other:		
7225.50.60	Of a thickness of 4.75 mm or more	5.8%	C
	Of a thickness of less than 4.75 mm:		
7225.50.70	Heat-resisting steel	4.1%	C
7225.50.80	Other	4%	C
7225.90.00	Other	5.8%	C
7226	Flat-rolled products of other alloy steel, of a width of less than 600 mm:		
7226.10	Of silicon electrical steel:		
7226.10.10	Of a width of 300 mm or more	5.8%	C
7226.10.50	Of a width of less than 300 mm	7%	C
7226.20.00	Of high-speed steel	12.5%	C
7226.91	Other:		
7226.91.10	Not further worked than hot-rolled:		
7226.91.30	Of tool steel (other than high-speed steel):		
	Of a width of 300 mm or more	9.6%	C
	Of a width of less than 300 mm	11.6%	C
7226.91.50	Other:		
	Of a thickness of 4.75 mm or more	3.8%	C
7226.91.70	Of a thickness of less than 4.75 mm:		
7226.91.80	Of a width of 300 mm or more	9.5%	C
7226.92	Of a width of less than 300 mm	6.3%	C
	Not further worked than cold-rolled (cold-reduced):		
7226.92.10	Of tool steel (other than high-speed steel):		
7226.92.30	Of a width of 300 mm or more	10.1%	C
	Of a width of less than 300 mm	10.6%	C
7226.92.50	Other:		
	Of a width of 300 mm or more	4%	C
7226.92.70	Of a width of less than 300 mm:		
	Not exceeding 0.25 mm in thickness	5.1%	C
7226.92.80	Exceeding 0.25 mm in thickness	6%	C
7226.99.00	Other	6.3%	C

SCHEDULE OF THE UNITED STATES OF AMERICA

Item	Article description	Base rate	Staging Category
7227	Bars and rods, hot-rolled, in irregularly wound coils, of other alloy steel:		
7227.10.00	Of high-speed steel	3.3%	C
7227.20.00	Of silico-manganese steel	4.3%	C
7227.90	Other:		
7227.90.10	Of tool steel (other than high-speed steel): Not tempered, not treated and not partly manufactured	2.1%	C
7227.90.20	Other	4.2%	C
7227.90.60	Other	4.3%	C
7228	Other bars and rods of other alloy steel; angles, shapes and sections, of other alloy steel; hollow drill bars and rods, of alloy or nonalloy steel:		
7228.10.00	Bars and rods, of high-speed steel	11.5%	C
7228.20	Bars and rods, of silico-manganese steel:		
7228.20.10	Not cold-formed	6%	C
7228.20.50	Cold-formed	7.5%	C
7228.30	Other bars and rods, not further worked than hot-rolled, hot-drawn or extruded:		
7228.30.20	Of tool steel (other than high-speed steel):		
7228.30.40	Of ball-bearing steel	6.1%	C
7228.30.60	Of chipper knife steel, not cold-formed	Free	D
7228.30.80	Other	10.6%	C
7228.40.00	Other	6%	C
7228.50	Other bars and rods, not further worked than forged	6%	C
7228.50.10	Other bars and rods, not further worked than cold-formed or cold-finished:		
7228.50.50	Of tool steel (other than high-speed steel)	10.6%	C
7228.60	Other	7.5%	C
7228.60.10	Other bars and rods:		
7228.60.60	Of tool steel (other than high-speed steel)	10.6%	C
7228.60.80	Other:		
7228.70	Not cold-formed	6%	C
7228.70.30	Cold-formed	7.5%	C
7228.70.60	Angles, shapes and sections:		
7228.80.00	Not-rolled, not drilled, not punched and not otherwise advanced	2.1%	C
	Other	5.3%	C
	Hollow drill bars and rods	5.7%	C
7229	Wire of other alloy steel:		
7229.10.00	Of high-speed steel	10%	C
7229.20.00	Of silico-manganese steel	9%	C
7229.90	Other:		
7229.90.10	Flat-wire	5.8%	C
7229.90.50	Round wire	9%	C
7229.90.90	Other wire	6.2%	C
	CHAPTER 73		
	ARTICLES OF IRON OR STEEL		
7301	Sheet piling of iron or steel, whether or not drilled, punched or made from assembled elements; welded angles, shapes and sections, of iron or steel:		
7301.10.00	Sheet piling	0.8%	C
7301.20	Angles, shapes and sections:		
7301.20.10	Of iron or nonalloy steel	2.8%	C
7301.20.50	Of alloy steel	3.9%	C

SCHEDULE OF CANADA

Item	Article Description	Base Rate	Staging Category
7217.33.00	—Plated or coated with other base metals	6.8%	C
7217.39.00	—Other	6.8%	C
	III. - STAINLESS STEEL		
72.18	Stainless steel in ingots or other primary forms; semi-finished products of stainless steel.		
7218.10.00	-Ingots and other primary forms	Free	D
7218.90	-Other		
7218.90.10	—Blooms, billets, rounds, slabs or sheet bars	4%	C
7218.90.90	—Other	10.2%	C
72.19	Flat-rolled products of stainless steel, of a width of 600mm or more.		
	-Not further worked than hot-rolled, in coils:		
7219.11.00	—Of a thickness exceeding 10mm	10%	C
7219.12.00	—Of a thickness of 4.75mm or more but not exceeding 10mm	10%	C
7219.13.00	—Of a thickness of 3mm or more but less than 4.75mm	10%	C
7219.14.00	—Of a thickness of less than 3mm	10%	C
	-Not further worked than hot-rolled, not in coils :		
7219.21.00	—Of a thickness exceeding 10mm	10%	C
7219.22.00	—Of a thickness of 4.75mm or more but not exceeding 10mm	10%	C
7219.23.00	—Of a thickness of 3mm or more but less than 4.75mm	10%	C
7219.24.00	—Of a thickness of less than 3mm	10%	C

SCHEDULE OF CANADA

Item	Article Description	Base Rate	Staging Category
	-Not further worked than cold-rolled (cold-reduced):		
7219.31.00	—Of a thickness of 4.75mm or more	10%	C
7219.32.00	—Of a thickness of 3mm or more but less than 4.75mm	12.5%	C
7219.33.00	—Of a thickness exceeding 1mm but less than 3mm	12.5%	C
7219.34.00	—Of a thickness of 0.5mm or more but not exceeding 1mm	12.5%	C
7219.35.00	—Of a thickness of less than 0.5mm	12.5%	C
7219.90	-Other		
7219.90.10	——Corrugated, cold-rolled, of a thickness not exceeding 4.75mm	12.5%	C
7219.90.90	——Other	10.2%	C
72.20	Flat-rolled products of stainless steel, of a width of less than 600mm.		
	-Not further worked than hot-rolled:		
7220.11.00	—Of a thickness of 4.75mm or more	10%	C
7220.12.00	—Of a thickness of less than 4.75mm	10%	C
7220.20	-Not further worked than cold-rolled (cold-reduced)		
7220.20.10	——Of a thickness exceeding 4.75mm	10%	C
7220.20.20	——Of a thickness not exceeding 4.75mm	12.5%	C
7220.90.00	-Other	10.2%	C
7221.00.00	Bars and rods, hot-rolled, in irregularly wound coils, of stainless steel.	10%	C
72.22	Other bars and rods of stainless steel; angles, shapes and sections of stainless steel.		
7222.10.00	-Bars and rods, not further worked than hot-rolled, hot-drawn or extruded	10%	C
7222.20.00	-Bars and rods, not further worked than cold-formed or cold-finished	12.5%	C
7222.30.00	-Other bars and rods	12.5%	C

SCHEDULE OF CANADA

Item	Article Description	Base Rate	Staging Category
7222.40	-Angles, shapes and sections		
7222.40.10	—Not further worked than hot-rolled or cold-rolled	7.8%	C
7222.40.90	—Other	10.2%	C
7223.00	Wire of stainless steel.		
7223.00.10	—Not coated or covered	6.8%	C
7223.00.20	—Coated or covered	7.8%	C

IV. - OTHER ALLOY STEEL; HOLLOW DRILL BARS AND RODS, OF ALLOY OR NON-ALLOY STEEL

72.24	Other alloy steel in ingots or other primary forms; semi-finished products of other alloy steel.		
7224.10.00	-Ingots and other primary forms	Free	D
7224.90	-Other		
7224.90.10	—Blooms, billets, rounds, slabs or sheet bars	4%	C
7224.90.90	—Other	10.2%	C
72.25	Flat-rolled products of other alloy steel, of a width of 600mm or more.		
7225.10	-Of silicon-electrical steel		
7225.10.10	—Cold-rolled or cold-drawn, of a thickness not exceeding 4.75mm	12.5%	C
7225.10.90	—Other	10%	C
7225.20	-Of high speed steel		
7225.20.10	—Cold-rolled or cold-drawn, of a thickness not exceeding 4.75mm	12.5%	C
7225.20.90	—Other	10%	C
7225.30.00	-Other, not further worked than hot-rolled, in coils	10%	C
7225.40.00	-Other, not further worked than hot-rolled, not in coils	10%	C

SCHEDULE OF CANADA

Item	Article Description	Base Rate	Staging Category
7225.50	-Other, not further worked than cold-rolled (cold-reduced)		
7225.50.10	——Of a thickness not exceeding 4.75mm	12.5%	C
7225.50.20	——Of thickness exceeding 4.75mm	10%	C
7225.90.00	-Other	10%	C
72.26	Flat-rolled products of other alloy steel, of a width of less than 600mm.		
7226.10	-Of silicon-electrical steel		
7226.10.10	——Cold-rolled, of a thickness not exceeding 4.75mm	12.5%	C
7226.10.90	——Other	10%	C
7226.20	-Of high speed steel		
7226.20.10	——Cold-rolled, of a thickness not exceeding 4.75mm	12.5%	C
7226.20.90	——Other	10%	C
	-Other:		
7226.91.00	—Not further worked than hot-rolled	10%	C
7226.92	—Not further worked than cold-rolled (cold-reduced)		
7226.92.10	——Of a thickness not exceeding 4.75mm	12.5%	C
7226.92.20	——Of a thickness exceeding 4.75mm	10%	C
7226.99.00	—Other	10%	C
72.27	Bars and rods, hot-rolled, in irregularly wound coils, of other alloy steel.		
7227.10.00	-Of high speed steel	10%	C
7227.20.00	-Of silico-manganese steel	10%	C
7227.90.00	-Other	10%	C

Item	Article Description	Base Rate	Staging Category
72.28	Other bars and rods of other alloy steel; angles, shapes and sections, of other alloy steel; hollow drill bars and rods, of alloy or non-alloy steel.		
7228.10	-Bars and rods, of high speed steel		
7228.10.10	---Not further worked than hot-rolled	10%	C
7228.10.90	---Other	12.5%	C
7228.20	-Bars and rods, of silico-manganese steel		
7228.20.10	---Not further worked than hot-rolled	10%	C
7228.20.90	---Other	12.5%	C
7228.30.00	-Other bars and rods, not further worked than hot-rolled, hot-drawn or extruded	10%	C
7228.40.00	-Other bars and rods, not further worked than forged	12.5%	C
7228.50.00	-Other bars and rods, not further worked than cold-formed or cold-finished	12.5%	C
7228.60.00	-Other bars and rods	12.5%	C
7228.70	-Angles, shapes and sections		
7228.70.10	---Not further worked than hot-rolled, cold-rolled, drawn or extruded	7.8%	C
7228.70.90	---Other	10%	C
7228.80	-Hollow drill bars and rods		
7228.80.10	---Not further worked than hot-rolled	10%	C
7228.80.90	---Other	12.5%	C
72.29	Wire of other alloy steel.		
7229.10.00	-Of high speed steel	6.7%	C
7229.20.00	-Of silico-manganese steel	7.4%	C
7229.90.00	-Other	7%	C

Senator METZENBAUM. Mr. Atwell, we are very happy to have you with us, Wayne Atwell, senior vice president for investment research, Goldman, Sachs and Company.

STATEMENT OF R. WAYNE ATWELL, SENIOR VICE PRESIDENT FOR INVESTMENT RESEARCH, GOLDMAN, SACHS & CO.

Mr. ATWELL. Thank you.

This morning I would like to direct my comments toward three issues. First, the state of the U.S. industry, and how current operating conditions have developed.

Second, the outlook for the U.S. steel industry.

And last, the impact of implementing the free trade agreement.

The twin demons of a strong dollar and severe recession had a devastating impact on the domestic steel industry during the first half of this decade.

Senator METZENBAUM. You are rolling so fast, Mr. Atwell, it is going to be a little difficult to hear you. So why do you not pull the mike up, just slow it down a little bit. We asked you here so we could understand what you were saying, so go right ahead.

Mr. ATWELL. Okay, let me start over.

Just briefly, I am going to discuss three points: the state of the U.S. steel industry; the outlook for the U.S. steel industry; and the impact of implementing the free trade agreement.

The twin demons of a strong dollar and severe recession had a devastating impact on the domestic steel industry during the first half of this decade. Based on our model, the average import-weighted exchange rate of steel producing nations declined 13 percent relative to the dollar between 1980 and 1985.

The strong dollar rendered U.S. manufacturing less competitive, which reduced steel demand, and made the U.S. steel industry less competitive and more susceptible to imports.

Between 1979 to 1985, U.S. net apparent supply declined 16 percent to 96 million tons. However, domestic shipments declined 27 percent to 73 million tons.

Imports rose during this period from 15 percent of our market to 25 percent of our market, and steel prices declined roughly 15 percent.

During 1982 to 1986, the domestic steel industry lost roughly $3 billion pretax, and roughly 20 percent of the industry went into bankruptcy.

In response to this environment, domestic steel managers were able to make once in a lifetime decisions, and take relevant actions.

Domestic capacity was rationalized, with high cost facilities closed. Raw steel capacity was reduced by 30 percent during the 10-year period ended in 1987, with the bulk of the capacity shuttered since 1982.

Domestic employment was reduced 60 percent since 1980, which doubled industry productivity. In addition, work rules were improved; raw material facilities rationalized; pension plans restructured; operating efficiencies increased; unprofitable product lines dropped; and nonstrategic assets sold.

The net result of these actions was to reduce cost on the order of 20 to 25 percent between 1980 and 1986. It was not, however, until the dollar began to weaken that the fortunes of the steel industry began to improve in the United States.

Based on our steel-weighted dollar model, the average cost of manufacturing steel by our trading partners, denominated in nominal dollars, rose 36 percent between 1984 and the third quarter of 1987, as a result of changes in currency values and in inflation in the local countries.

Domestic steel industry fundamentals have improved dramatically in the last 12 months due to the impact of cost-cutting, the weak dollar, and continued economic recovery.

Senator METZENBAUM. What was the first one? Due to what?

Mr. ATWELL. The cost-cutting, the weak dollar and the continued economic recovery.

The industry order rate has been running at 90 to 100 percent the last 12 months. We are currently operating at 95 percent utilization rate in our equipment.

The first quarter earnings for the industry were the best in 7 or 8 years. The financial condition of the industry has improved materially, and the shares were one of the best groups on the equities market over the past year.

Senator ROCKEFELLER. Could I interrupt for a second?

Mr. ATWELL. Yes.

Senator ROCKEFELLER. In the list of the reasons why things had improved, you did not talk about modernizing equipment and plants. Was that left out deliberately?

Mr. ATWELL. Well, you could consider that cost-cutting. Steel technology moves at a glacial pace. And the industry is very capital intensive. It takes a long time, and is very expensive to implement changes in technology.

Senator ROCKEFELLER. But how would you characterize putting money into plants and equipment?

One of the problems that I see is that what you are saying in this paragraph is true, but that there is an upcoming problem where a number of companies are going to have to spend enormously on a variety of costly things. I just wanted to get your view.

Mr. ATWELL. This is a good point. But, you have to realize, that in the financial community, we have a shorter time horizon than most people. Security investments generally are on the order of 6 to 18 months. So we tend to think on a shorter time basis.

Managements in industry would have to make decisions on a 5 to 10 year basis. To be competitive, you have to implement new technology.

I guess I'm trying to identify what changed the fortunes of the industry over the short term. Without the dollars being spent on technology and improving efficiencies, certainly the industry would be in very bad shape fairly quickly.

Mr. ATWELL. The major fact as contributing to turning the industry around, were cost-cutting and the dollar. I take technology and modernization as a given.

I have been following the industry for almost 20 years, and in my opinion, the bulk of the capital spending is actually behind us except for a few cases.

The BOFs were by and large replaced over the last 15 or 20 years——

Senator METZENBAUM. The what?

Mr. ATWELL. The Basic Oxygen Furnaces were basically replaced over the last 20 years, and a large number of the continuous casters have been constructed. This is capital intensive equipment.

So most plants, or a lot of plants, are fairly modern at this point. That is not to say they are the best in the world, but they are fairly modern.

The capitol to be spent from here on will be mostly put into the finishing end.

At this point there are only three continuous casters under construction, or under the planning stage right now.

One of the major reasons the financial condition of the industry deteriorated during the early 1980's related to 10 years of heavy capital spending by the industry capped by a meaningful decline in earnings. Most recently cash flows have improved dramatically, while capital spending is down fairly sharply.

Managements have been improving balance sheets through assist sales, equity offerings and debt repurchases at a discount.

Senator ROCKEFELLER. Thank you.

Mr. ATWELL. We believe strong industry fundamentals could persist for several years, interrupted only by a recession

But there are several reasons for concern about the next 5 to 10 years. The VRAs expire September, 1989; and pressure from imports in the domestic market will pick up.

Current profit and cash flow levels for the domestic industry are quite high due in part to tax loss carry-forwards, but these will be used up during the next 3 or 4 years.

Industry labor contracts expire mid-1989, and as the hourly workers' compensation is at approximately the same as it was in 1983; wage and benefit demands should be considerable.

The U.S. economy will continue to become less steel intensive. This should result in little if any steel consumption growth over the next 10 years.

The industry will continue to be subject to competition from state-owned and state-subsidized steel companies. Domestic cost cutting sharply reduced our costs in a crisis environment.

Other countries such as Japan are now rationalizing and cutting costs. The U.S. lead in cost-cutting is unlikely to last.

And lastly, the dollar may reverse its decline and diminish the U.S. competitive position.

The impact of the trade agreement is as follows: in order to understand the implications for the FTA, it is important to put the U.S. and Canadian industries in perspective.

Foreign trade is much more important to Canada than to the United States. Exports average 20–25 percent of apparent Canadian supply between 1979 and 1987, versus 2 percent of apparent supply for the United States.

Canada is a net exporter; the United States is a net importer.

Over the last 5 years, exports from Canada to the United States have been approximately five-to-six times the level of exports from the United States to Canada.

The last 5 years, Canadian exports to the U.S. have accounted for 3.3 percent of apparent consumption, while U.S. exports to Canada have run 5.3 percent

Canada has a much smaller economy, and a given amount of imports obviously has a greater impact on their market than ours.

The importance of the U.S. market to Canada is further demonstrated by the fact that approximately 85 percent of Canadian exports over the past 5 years were to the United States, while only 34 percent of U.S. exports were to Canada.

The United States has a voluntary restraint agreement which most of the major trading partners have been under for the last 3½ years. Imports declined from 26 percent of the U.S. market in 1984, to 21 percent in 1987.

As we have heard earlier, Canada is not included in the VRA program. Its exports to the United States during this time period rose 16 percent on an absolute basis.

Since 1984 the Canadians' share of U.S. imports has risen to 18 percent from 12 percent.

Canadian steel costs are lower than those in the United States. In my opinion, the two major factors that explain this are the lower Canadian dollar, and a lower wage rate on the order of 15 to 20 percent.

Between 1980 and 1986, the U.S. dollar appreciated 19 percent versus the Canadian dollar. From the end of 1986 to date, the Canadian dollar has appreciated 11 percent versus the U.S. dollar, reversing slightly more than half of the deterioration during the previous period.

The Canadian industry appears to be using the U.S. market to dampen the impact of domestic recessions on shipments. Between 1979 and 1982, the last serious recession, Canadian shipments declined significantly less than net apparent supply in the domestic market.

This can be accounted for by the increase in exports.

In theory, the Federal Trade Agreement should benefit the U.S. industry more than the Canadian industry, as Canadian tariffs are 50 to 100 percent higher than those in the United States.

Nonetheless, I have the following concerns. One, the Canadian tariffs will remain above those in the United States, even as they scale down.

Two, the Canadian industry has lower costs, so exporting to the United States will be more attractive than vice versa.

Three, Canada has more of a tradition of exporting steel than does the United States.

In summary, I believe the United States can compete under the FTA program. However, Canada can be expected to use the U.S. market to dampen the impact of a recession on its steel industry.

In order to move the two industries in the direction of a level playing field as fast as possible, I believe the Canadian tariffs should decline at a faster rate than those of the United States.

Senator METZENBAUM. Thank you very much, Mr. Atwell.

Mr. Atwell, let me ask you: What were the total earnings, if you know, of the American steel industry in 1987 as related to the equity investment, and also, as related to the gross volume?

And I am now talking about earnings absent taxes, and absent any other special depreciation rules or recovery from past losses that the Congress made possible?

Mr. ATWELL. Unfortunately, I analyze the industry on a company by company basis and do not look at industry members.

Senator METZENBAUM. Can you tell us the facts with respect to USX, for example, or any of the other majors?

Mr. ATWELL. Certainly. Let me refer to a publication I just put out. I think as mentioned earlier, a large part of the profits last year related to the investment tax credits, which were included in the earnings report.

The net income of Armco was $115 million. Roughly a third of this would have been from the investment tax credit, and they had a number of more or less offsetting gains and losses——

Senator METZENBAUM. Are you reading from this book here?

Mr. ATWELL. Yes.

Senator METZENBAUM. What page are you on?

Mr. ATWELL. Page 39.

Senator METZENBAUM. Thank you.

Mr. ATWELL. Armco, as I said, reported $115 million in earnings. Roughly a third of this was from the investment tax credit, which they reported as earnings.

They had a number of more or less offsetting profit and loss items, so they would have generated a profit of $70 to $80 million after tax.

Senator METZENBAUM. And their total volume was about $478 million, is that——

Mr. ATWELL. Their total shipments were 4.9 million tons.

Senator METZENBAUM. 4.9 million tons. And the total volume?

Mr. ATWELL. You're talking sales?

Senator METZENBAUM. Dollar volume; 1 billion 940, does that sound right to you?

Mr. ATWELL. I think it was around $3 billion, between $2½ and $3 billion.

If you would refer to the next page, Bethlehem Steel, page 40, they reported a profit of $174 million. Of this, roughly $130 million was from the ITC.

So they had a minimal profit last year. I did not prepare remarks to come up with numbers such as this, but I would imagine their profit was on the order of $40 or $50 million.

Inland last year reported $142 million in profits; 15 million of this was from the investment tax credit. So their earnings would have been on the order of around $80 million. On balance, last year was not a highly profitable year.

Senator METZENBAUM. Was not a very profitable year?

Mr. ATWELL. Was not a very profitable year, and that can be divided into the first half which was break-even or in the red and the last half which was better.

Senator METZENBAUM. How much did the steel industry raise their prices on the average on a ton in 1987?

Mr. ATWELL. Well, let me answer it a different way. We can get to that number.

Senator METZENBAUM. Perhaps somebody else can answer that.

Mr. ATWELL. Well, average steel a ton sells for maybe $450. Prices, on average, last year were up on the order of about 4 or 5 percent. This is a complicated issue.

A number of contracts are long-term contracts. The actual spot price for steel in some cases was up 30 percent, but the average was up about 5 percent versus the year earlier.

Senator METZENBAUM. Is the investment industry recommending steel as a short-term or long-term investment?

Mr. ATWELL. Well, in this document my conclusion was that the steel stocks are quite attractive based on the secular case; that I think we could make a great deal of money investing in them. They are very high-risk due to the nature of the business and the volatility in their earnings and performance.

However, more specifically, over the short term there has been a very high operating rate most recently and, in my opinion, inventory-building.

Senator METZENBAUM. Very high offering?

Mr. ATWELL. Operating rate.

In my opinion, there has been inventory-building in the industry over the short term. I mean, this is not terribly relevant for your hearings, maybe, but over the short term it looks like we will have a slow-down in the second half due to a correction in the inventory level at consumers.

On a very short-term basis, I would not be inclined to buy the shares until we see a bit of a correction in the second half of the year. On a 2 or 3 three year basis, I think the steel shares are very attractive for people willing to assume a high degree of risk.

Senator METZENBAUM. What is the situation with respect to inventories at the moment in the steel industry generally?

Mr. ATWELL. Well, we do not have good numbers on that. They are more or less derived numbers. We estimate consumption, we have shipments, and we back out an inventory number. I am looking for inventories to rise on the order of about 3 million tons this year, following a 3-million-ton build last year. Domestic shipments are estimated to run 77 million tons.

Senator METZENBAUM. You are talking about industry inventories building?

And what kind of an inventory do you who are in the investment area consider to be an appropriate inventory for the steel industry to be carrying?

Mr. ATWELL. Well, inventory is held by a number of participants in the industry. Both producers and consumers hold inventory. We generally look at consumer inventories as the potential concern because producers have more control over their own inventories and they typically do not build much inventory.

Again, we do not have specific numbers because no one is really willing to volunteer that, so I honestly do not have a good, hard number like 4 weeks, 8 weeks. We generally start from a recession low, assuming that is the lowest sustainable level, as our base. We factor in supply, demand, imports and exports and devise a number which represents the change for the year.

Senator METZENBAUM. If the exchange rate should change worldwide—that is, as against the yen—would the American domestic

steel industry just have a tremendous drop in its profitability as well as its production?

Mr. ATWELL. Now, let me understand your question. Are you saying if the yen depreciates the dollar, would that impact us?

Senator METZENBAUM. Yes.

Mr. ATWELL. At this point in time, our costs are significantly lower than the Japanese, on the order of 15 to 25 percent. So it would depend on the magnitude of the drop in the yen versus the dollar.

If it were to decline 5, 10 or 15 percent, I do not think it would have much of an impact. If the yen were to decline 30, 40 or 50 percent, it would have a significant impact.

But at this point in time, we can actually export steel to Japan more economically than they can export it to us.

Senator METZENBAUM. The Canadian industry says that it is unofficially limiting its steel exports to the United States at the urging of the Commerce Department. Do you believe that that is an accurate representation?

Mr. ATWELL. Well, the statistics would not indicate that that seems to be the case. In 1983, their share was about 2.9 percent, then it rose to 3.2 percent in 1984, to 3.0 percent in 1985 to 3.6 percent in 1986, and to 3.8 percent in 1987. So, actually, since the VRAs have been implemented, their share of our market has grown by a third. They have gone essentially from 3 percent to 4 percent, so the facts do not seem to support that.

Senator ROCKEFELLER. Mr. Chairman, could I just interject one thing?

Senator METZENBAUM. Please.

Senator ROCKEFELLER. Your page 3 was interesting to me, Mr. Atwell, because you lay out a scenario and then you have just said that we can export to Japan more cheaply than they can to us.

Getting back to this question of modernization and expenditure in plant equipment—this is my basic concern in trying to understand the current state of health of the industry and, therefore, what the FTA might mean to it.

You say that other countries, such as Japan, are now rationalizing and cutting costs sharply, and, therefore, our cost-cutting lead will probably disappear. That is a fairly basic question.

You indicated that, for the most part, modernization has been carried out. This indicates that, to some degree, it has not, at least in several companies. I can certainly think of several companies where it has not been done.

But then you seem to be indicating that where it has been done, it will still not be sufficient once the others go through their cyclical rationalizing which you talked about.

I am just interested in where we are in terms of modernization.

Mr. ATWELL. Cost-cutting is not necessarily synonymous with spending money on equipment. For instance, we eliminated 60 percent of our labor force and we did not have to spend meaningful cash.

Senator ROCKEFELLER. Understood. I am just looking at the expense on capital expenditures that will have to come.

Mr. WEIGEL. I disagree with Mr. Atwell on the subject that our capital investment is largely behind us. It is true that a great deal

of money has been spent on melting and casting facilities, but the real dollars and capital investment are required in the hot-rolling end of it.

There is not a single modern small bar mill in the United States that can compete with the bar mills in Europe and Japan. An interesting thing about capital investment in the steel industry is that it takes about two dollars of capital investment to generate one dollar's worth of annual revenue, about twice the average of American industry.

I think one of the biggest problems that we have had in being competitive—and competitive is not only a question of price, it is a question of quality—has been our ability to invest in the modern rolling mills, the modern finishing equipment that is available around the world. Our foreign competitors on the other hand have had direct subsidies to their capital investment, as well as very substantial investment incentives to investment.

Mr. DEANER. If I may, the revenue for the entire industry last year was—if I have my decimal point right here—some $26,818,000,000. That is the revenue, and capital expenditure last year was about $1.1 billion. Earnings last year were about $1 billion.

Senator METZENBAUM. Would you say that again?

Mr. DEANER. Yes.

Senator METZENBAUM. $26 billion?

Mr. DEANER. $26,818,000,000 was the revenue, and capital expenditures were about $1.1 billion.

Senator METZENBAUM. $1 billion?

Mr. DEANER. Yes, sir, and earnings for all of the industry, not just the Institute members, were about $1 billion and that, of $1 billion, roughly half came from investment tax credits and about a quarter billion, or $250 million, came from asset sales. We are not yet well.

How much should we be spending on capital? At least $2 billion, and we are spending $1 billion. For example, an industry is considered fully modern if it has a hundred percent continuous casting. We are averaging just under 60 percent of a down-sized industry. We need another 40 percent.

A million tons of continuous casting capacity is over $100 million, so we need $4 billion just to put in continuous casters that are needed if we are to remain world-competitive. I think we are spending half of what we should be. We have done a wonderful job, but there is a long way to go.

The selling price, you asked about it, and in the Institute we do not collect any data on prices. There has been a lot of press about what has happened to prices, and I think you will find the selling price of steel today is less than it was in 1981 or 1982.

Senator METZENBAUM. You are talking about that after making allowances for inflation?

Mr. DEANER. No, sir; no, sir, dead-out numbers, making no allowances for inflation.

Senator METZENBAUM. And the per-ton price of steel today is less than it was in 1981 and 1982?

Mr. DEANER. I believe that to be true.

Mr. ATWELL. The price of steel declined about 15 percent between 1980 and 1986, and it is back up about 5 percent.

Senator METZENBAUM. I am sorry?

Mr. ATWELL. The price of steel declined around 15 percent between 1980 and 1986, and it is up about 5 percent over the last year or so. So it is still on the order of about 10 percent lower than it was in 1980, and that is unadjusted for inflation.

Mr. DEANER. Another point on modernization, just to throw a number at you perhaps you would enjoy: in 10 years one of the major measures of efficiency, crude steel to finish shipments, has gone from about 72 percent to about 86 percent, which is a savings of about $4 billion annually.

[The statement of Mr. Atwell follows:]

PRESENTATION BY R. WAYNE ATWELL, GOLDMAN, SACHS & CO.

This morning I would like to address the following three issues:

1. The state of the U.S. steel industry and how current operating conditions have developed.

2. The outlook of the U.S. steel industry.

3. The impact of implementing the Free Trade Agreement.

The twin demons of a strong dollar and a severe recession had a devastating impact on the domestic steel industry in the first half of this decade. Based on our model, the average import-weighted exchange rate of steel producing nations declined 13% between 1980 and 1985. The strong dollar rendered the U.S. manufacturing sector less competitive, which reduced steel demand, and made the U.S. steel industry less competitive and more susceptible to imports. Between 1979 and 1985, U.S. net apparent supply declined 16% to 96 million tons, and domestic shipments declined 27% to 73 million tons. Imports rose from 15% of the U.S. market to 25% over the six years ended 1985, and steel prices declined roughly 15% between 1980 and 1986. In this environment, during the 1982–1986 period, the domestic steel industry lost $3.0 billion, and roughly 20% of the industry went into bankruptcy. To make matters worse, the industry was in a heavy capital spending mode, and the financial strength of the industry was severely strained.

In response to this environment, domestic steel managements were able to take once-in-a-lifetime actions. Domestic capacity was rationalized, with high-cost redundant facilities closed. Raw steel capacity was reduced 30% during the ten-year period ended 1987 with the bulk of this capacity shuttered since 1982. Industry employment has been reduced 60% since 1980, which has doubled industry productivity. In addition, work rules were improved, raw material facilities rationalized, pension plans restructured, operating efficiencies increased, unprofitable product lines dropped, and nonstrategic assets sold.

The net result of these actions was to reduce costs 20%–25% between 1980 and 1986. It was not, however, until the dollar began to weaken that the fortunes of the domestic steel industry began to improve. Based on our steel-weighted dollar model, the local cost of manufacturing steel denominated in nominal dollars rose 36% between the end of 1984 and the third quarter of 1987 as a result of the impact of changing currency values and foreign inflation levels.

Domestic steel industry fundamentals have improved dramatically the last 12 months due to the effects of industry cost cutting, the weak dollar, and continued economic recovery. The industry's order rate has been running at 90%–100% of capability for most of the last year, it is currently operating at 95% of capability, first quarter earnings were the best in seven or eight years, its financial condition has improved materially, and its shares have been among the best performing in the equity market.

We believe that the strong fundamental conditions in the U.S. steel industry could persist for several years, interrupted only by a modest recesson, but there are reasons to be concerned about the outlook over the next five to ten years.

1. The VRAs expire in September 1989, and import competition in the domestic market will consequently pick up.

2. Current profit and cash flow levels for the domestic industry are quite high due to tax-loss carryforwards that should be used up in 3–4 years.

3. The industry labor contract expires mid-1989, and as the hourly workers' compensation is approximately the same level in 1983, wage and benefit demands will be considerable.

4. The U.S. economy will continue its trend of reduced steel intensity. This should result in little, if any, growth in steel demands over the next ten years.

5. The industry will continue to be subjected to competition from state-owned or state-subsidized steel companies.

6. The U.S. industry cut costs sharply because of the crisis environment. Over countries, such as Japan, are now rationalizing and cuting cost sharply. The United States' lead in cost cutting is unlikly to last.

7. The dollar may reverse its decline and diminish the United States' competitive position.

IMPACT OF FREE TRADE AGREEMENT (FTA)

In order to understand the implication of the FTA it is important to put the United States and Canadian steel industries in perspective.

Foreign steel trade is much more important to Canada than to the United States. Exports averaged 20–25% of apparent Canadian supply between 1979 and 1987, versus only 2% of U.S. apparent supply. Canada is a net exporter; the United States is a net importer. Over the last five years exports from Canada to the United States have been approximately ten times the level of exports from the United States to Canada. Over the last five years, however, Canadian exports to the United States have accounted for 3.3% of U.S. apparent consumption, while U.S. exports to Canada have run 5.3%. Canada has a smaller economic base than the United States, and a given level of imports has a greater impact on its market.

The importance of the U.S. market to Canada is further demonstrated by the fact that approximately 85% of Canadian exports over the last five years were to the United States, while only 34% of U.S. export were to Canada.

The United States has had voluntary restrain agreements (VRAs) with most of its major trading partners for the last three and a half years. Imports declined from 26% of the U.S. market in 1984 to 21% in 1987. Canada is not included under the VRA program, and its exports to the United States have increased 16% since the program was implemented. Since 1984, the Canadian share of U.S. imports has risen to 18% from 12%.

Canadian steel costs are lower than those in the United States. In my opinion, the two major factors which explain this are, lower Canadian wage rates (15%–20%) and the decline in the Canadian dollar relative to the U.S. dollar. Between 1980 and 1986, the U.S. dollar appreciated 19% versus the Canadian dollar (Table 2). From the end of 1986 to date, the Canadian dollar has appreciated 11% against the U.S. dollar, reversing more than half the impact of the previous U.S. dollar appreciation. The Canadian steel industry appears to have used the U.S. market to dampen the impact of domestic recessions on its steel shipment. Between 1979 and 1982, Canadian shipments declined significantly less than net apparent domestic supply.

In theory, the Federal Trade Agreement (FTA) should benefit the U.S. steel industry more than the Canadian industry. Canadian tariffs are 50%–100% higher than those in the United States. Nonetheless I have the following concerns.

1. The Canadian tariffs will remain above those in the United States, even as they are scaling down.

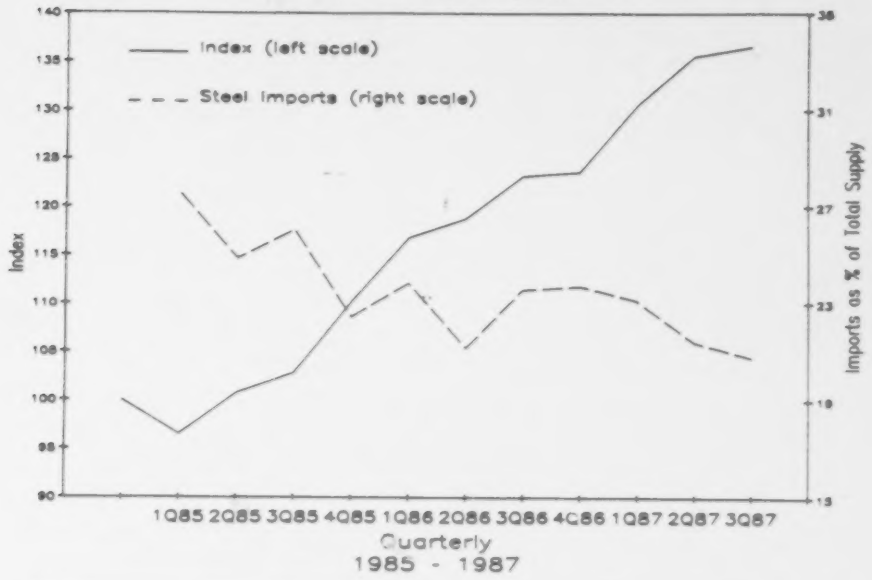
2. The Canadian industry has lower costs, so exporting to the United States is more attractive than visa versa.

3. Canada has more of a tradition of exporting steel than does the United States.

In summary, I believe that the United States can compete if the FTA is implemented; however, Canada can be expected to use the U.S. market to dampen the impact of a recession on its steel shipments. In order to move the two steel industries in the direction of a level playing field as fast as possible, I believe that Canadian tariffs should decline as a faster rate than those in the United States.

Steel Relative Cost Index

of Major U.S. Importing Nations



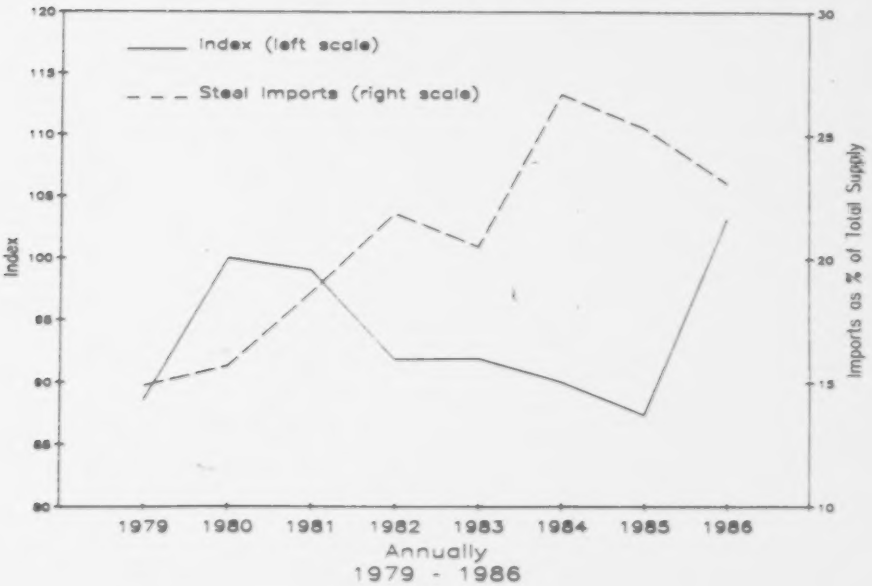


Table 1
Domestic Raw Steel Capacity, 1977-1987

(million short tons)

		% change from previous year	Cumulative % change
1977	160.0		
1978	157.9	-1.3 %	-1.3 %
1979	155.3	-1.6	-2.9
1980	153.7	-1.0	-3.9
1981	154.3	0.4	-3.6
1982	154.0	-0.2	-3.8
1983	150.6	-2.2	-5.9
1984	135.3	-10.2	-15.4
1985	133.6	-1.3	-16.5
1986	127.9	-4.3	-20.1
1987	112.4	-12.1	-29.8

Source: American Iron and Steel Institute.

Table 2
Canadian Dollar versus the U.S. Dollar, 1972-1988

(per U.S. dollar)

1972	0.990	1987 Jan	1.362
1973	1.000	Feb	1.334
1974	0.978	Mar	1.320
1975	1.017	Apr	1.319
1976	0.986	May	1.341
1977	1.063	June	1.339
1978	1.141	July	1.326
1979	1.171	Aug	1.327
1980	1.169	Sept	1.317
1981	1.199	Oct	1.310
1982	1.234	Nov	1.317
1983	1.232	Dec	1.308
1984	1.295	1988 Jan	1.286
1985	1.365	Feb	1.269
1986	1.390	Mar	1.250
1987	1.326	Apr	1.235

Note: Average exchange rate for the period.

Senator METZENBAUM. The Ambassador has arrived. I am very happy to have you with us.

I might say that I think at this point I should put in the record a very short statement from the United Steel Workers of America addressed to me as Chairman of this hearing.

"USWA, as an affiliate of the AFL-CIO, supports the position that the U.S.-Canada FTA is not in our best interests. Additionally, as a union with membership in the steel industry, we would alert the Caucus to assure that the FTA in no way inhibits any subsequently negotiated arrangements between the governments regarding steel trade flows."

It is signed by Lynn Williams.

The timing of that had nothing to do with your arrival. It was just handed to me by staff.

[Laughter.]

We are very happy to have you with us and look forward to your statement. Certainly, we will have some questions.

Ambassador YEUTTER. Well, thank you.

Senator METZENBAUM. I think that the understanding that you came with was that you would submit to questions from members of the Senate, but not from others.

STATEMENT OF CLAYTON YEUTTER, U.S. TRADE REPRESENTATIVE; ACCOMPANIED BY WILLIAM MERKIN, DEPUTY ASSISTANT U.S. TRADE REPRESENTATIVE FOR CANADA, AND ROBERT CASSIDY, DIRECTOR, STEEL TRADE POLICY

Ambassador YEUTTER. Well, I think that is the arrangement. It does not trouble me to take questions from anybody, as you know, Mr. Chairman.

Senator METZENBAUM. They can ask questions, as long as they are not too tough.

Ambassador YEUTTER. No. As a matter of fact, I do not mind the tough ones either.

Senator METZENBAUM. All right.

Ambassador YEUTTER. But time is precious and we have got a lot on the agenda this week, as we are trying to do a thousand things before we go to the OECD meetings in Paris next week. So I am just trying to conserve my time as best I can, Mr. Chairman.

Senator METZENBAUM. Please proceed.

Ambassador Yeutter. I will do this very briefly, Mr. Chairman, because I do not think there is any need for any lengthy statement. The fact that you just announced the submission of the statement by the steel workers' union gives me an opportunity to say a couple of words about the agreement as a whole and its applicability to steel, because I find that position just completely indefensible.

In my judgment, there is nothing in this agreement, nothing, that would work to the disadvantage of the steel workers of this country or the steel industry of this country. I find it very hard to believe that there could be anything at all that would provoke that kind of statement.

I will be more specific in a minute, Mr. Chairman, but first of all, just a couple of overall comments. Overall, it seems to me and to all the economists who have looked at the agreement that it is clearly in the best interests of both countries.

I have not seen any economist anywhere who has done an estimate of the potential effected agreement come to any conclusion other than that it will augment the economic growth of both countries.

The disagreements among the economists are purely on how much growth will increase in the United States and how much growth will increase in Canada. Nobody is suggesting that there will be a decline.

Senator METZENBAUM. Would you spell out how you see that happening? Why does that happen?

Ambassador YEUTTER. For a lot of reasons, Mr. Chairman, but let me just take two or three of the major ones. One obviously is just the total elimination of all tariffs between the two countries over 10 years, which, as you know, is the intent of the agreement, and there will be a 10-year phase-out on steel.

Some of the other products will phase out in 5 years; some will go immediately upon implementation next year. But just eliminating the thousands of tariff lines adds to the efficiency of movement of product and raw material between the two countries, and it will just stimulate a higher level of economic activity between the two countries and, in addition, will have the synergistic effect of making companies in both countries more efficient vis-a-vis their competitors elsewhere in the world.

So there will be more economic activity going back and forth between the two borders and companies of both countries, with the additional economies of scale of a North American market, if you will, will add to their own international competitiveness as they compete in Asia, Europe, or elsewhere.

Senator METZENBAUM. What is the relative relationship of tariffs, steel-wise, Canadian now as against Americans?

Ambassador YEUTTER. We will be the beneficiaries in that area, too, Mr. Chairman, because Canadian tariffs are about double ours. They are a little over 8 percent, on the average, on our products going into Canada and they are a little under 4 percent on Canadian products coming this way.

So we will be the beneficiary of the phase-out of the tariffs. In fact, interestingly, some segments of our steel industry, Mr. Chairman, are now asking if we would go back once the agreement goes into effect and engage in some additional negotiations with our Canadian colleagues to try to accelerate the tariff staging.

As I indicated, it is a 10-year staging process now and we have got some industries that would like to get it phased out faster.

Senator METZENBAUM. On a straight-line basis?

Ambassador YEUTTER. Yes, 10 percent a year for 10 years.

Some of our steel producers see export opportunities in Canada that they believe would be enhanced if we could phase it faster and they are asking us to do that. Obviously, our Canadian colleagues are not going to do this for free, but it is certainly possible to negotiate and, you know, we are prepared to do that subsequent to the agreement going into effect. But at any rate, overall, there are going to be significant benefits.

One other item that I would add, Mr. Chairman, because it applies in steel and a lot of other manufacturing industries—it is

very important in your State and many other manufacturing States—is energy.

I really believe one of the great potential benefits to the United States in this agreement comes in the energy provisions where we will forever more, hopefully, at least as long as the agreement is in effect, have secured access to Canadian energy supplies and what is called national treatment in the pricing of those supplies, meaning that Canada——

Senator METZENBAUM. How will that help the Ohio coal industry?

Ambassador YEUTTER. Well, the coal industry will be helped, as a matter of fact, by these energy provisions because the increased economic activity is going to stimulate additional coal exports.

I think our coal people who are worried about this agreement are inappropriately worried.

Senator METZENBAUM. The Ohio Power Authority, I am advised by staff, opposes the FTA. As you bring in energy from Canada, it would seem to me that it would make it that much more difficult for Ohio coal to be marketed throughout the rest of Ohio as well as to export it.

The Ohio coal industry, as well as West Virginia, Kentucky, and other States nearby have certainly had many challenges in recent years as far as their viability is concerned, and profitability.

Ambassador YEUTTER. Yes.

Senator METZENBAUM. I think it is a real concern and I guess I would like to have you tell me how bringing in energy from Canada is not going to hurt Ohio coal sales.

Ambassador YEUTTER. Well, first of all, we will be glad to give you a more detailed analysis, Mr. Chairman, if you would like to have it, over and above what we talk about today, because we are a little outside of the periphery of steel now.

Senator METZENBAUM. I understand that, but it is not outside my interest.

Ambassador YEUTTER. That is okay, that is all right, because it is a legitimate question and it has come up before.

The analysis that our folks have done would indicate that they believe that the U.S. coal industry will come out fine. Now, with respect to your specific—and I am giving an aggregate, overall feel now for the U.S.-Canadian trade, not just Ohio's particular interests, and we would have to zero in more specifically on that, of course.

But for the energy side as a whole, you have a lot of manufacturing industries where energy is a big input cost, and to the degree that these provisions will give them some protection in terms of both security of access to energy supplies other than coal now, I am talking about, and also some security on the pricing side, they are clearly going to be the beneficiaries. Your manufacturing industries over the next 50 years are going to benefit from this.

Senator METZENBAUM. There has been a real concern expressed by the National Steel Producers Association, who indicated that with a voluntary restraint agreement they would be supporting the FTA. You correct me if I am misstating your position. Without it, they would not be supporting it. Now, I think that is the way I understood your responses.

What is the status with respect to Canada refusing to join the VRA?

Ambassador YEUTTER. The FTA affects that issue not at all. So to suggest that there should be opposition to the FTA because there is not a VRA really makes no sense at all, because without an FTA there will still be no VRA. So, you know, that situation is entirely unchanged.

There is nothing, Mr. Chairman, in the FTA that precludes us from negotiating a VRA with Canada. We can negotiate it now before the FTA goes into effect. We can negotiate a VRA after the FTA goes into effect, if we wish.

Now, the reason we have not negotiated a VRA with Canada, as everybody knows, is because the VRAs were done with countries that have exemplified unfair trading practices in steel.

The President's steel program has never contemplated the negotiation of VRAs with countries where there has been no demonstrable evidence of unfair trading practices. Thus far, I have not seen demonstrable evidence of Canada engaging in unfair trade practices in steel.

As a matter of fact, I do not see any cause for complaint at all on the Canadian—well, not at all, but for significant complaint on the Canadian side now because the percentage of import penetration from Canada has been coming down in recent months and we do not see it as a significant threat.

When the industry is operating at 95 percent of capacity, it is pretty hard to build a persuasive case that Canada or anybody else is taking advantage of them.

Senator METZENBAUM. I am sorry. I did not see Senator Specter here.

Senator SPECTER. Mr. Chairman, would you yield for a question at this point?

Senator METZENBAUM. Certainly. I apologize. I did not know you were here.

Senator SPECTER. Ambassador Yeutter, you have just said that the Canadian penetration has lessened, you said, in the last few months, and that may be the difference between your statement and the statistics I have, but the information which has been made available to me shows that imports of finished steel from Canada were 2.4 percent of the market in 1983, 3 percent in 1984 and 1985, 3.5 percent in 1986, and 4 percent in 1987. Those imports now account for nearly 60 percent of the total non-VRA imports.

Are those statistics accurate?

Ambassador YEUTTER. I would assume that they are accurate, Senator Specter.

Senator SPECTER. Were you then referring to perhaps, as you said, I think, in the last few months that something has happened of a decisive nature since 1987?

Ambassador YEUTTER. Very much so. In fact, here are the charts. You cannot see it very well, but the fact is that the Canadian numbers went up, very much related to the time of the U.S. Steel strike, and then since then they have been coming back down.

I have got two or three charts or graphs that reflect this and I would be glad to share them with you.

Senator SPECTER. Well, what are the figures after 1987?

Ambassador YEUTTER. Well, we are now down to somewhere around 3 percent of penetration now, which is somewhat slightly higher than it was 2 or 3 years ago, but these are not startling numbers.

Part of the reason that they are that high, Senator Specter, is because there is tremendous demand for U.S. steel products and we have got a short supply situation with some our steel products today and some products coming into Canada to respond to the short supply situation that we have here.

When our steel firms cannot meet the demand, our buyers in the U.S. have to get it from somewhere.

I just answered a letter yesterday, Senator Specter, to one of your colleagues in the Senate who was writing in to me complaining about the fact that we have all these VRAs that are keeping the constituents in his State from buying steel, and I said that I hoped he would remind some of his colleagues about that when they argue that we need even tighter VRAs on steel.

Senator SPECTER. Let me just follow up with one or two more questions, Mr. Chairman.

Ambassador Yeutter, the issue on the Free Trade Agreement as it ties into VRAs, I think really poses an opportunity for some leverage and for some special occasion to have Canada commit to some voluntary restraints. I think that is what some people are looking for when this Free Trade Agreement is in the process of consideration by the Congress.

So I think the real issue is whether it is in our interest to extract some commitments from the Canadians on the voluntary restraint agreement. We have a tough situation in the steel industry. Our steel production has contracted very substantially, more significantly from my State perhaps than Senator Metzenbaum's State.

So when we find that there are more opportunities for imports, it is because we have had so much contraction of the steel industry, certainly in western Pennsylvania in Bethlehem and Johnstown and other places.

The real issue, it seems to me, turns on longer-range projections, and I think it is a fair question to ask whether this might not be an opportune time to say to our Canadian friends, how about some voluntary restraints, how about a commitment here.

Does that not make sense?

Ambassador YEUTTER. Well, the negotiation is over, Senator Specter, so we cannot go back and do that.

Senator SPECTER. Well, the negotiation is not over in the Congress.

Ambassador YEUTTER. Well, but we made it very clear to the Congress that we cannot renegotiate this agreement. If we renegotiate the steel provisions of the agreement, then the entire agreement will unravel. Whether it be steel or anything else, we are dealing with implementing legislation now and not with renegotiation of the agreement.

There is nothing that precludes us, however, Senator Specter, from going back and negotiating further on this or anything else in future years. But as to whether a VRA would be a good idea with Canada, at least this administration would not accord with that viewpoint until and unless there is some indication of unfair trade

practices on the Canadian side of the border, and we do not yet see that occurring.

Senator SPECTER. Have there been any efforts by the administration to get a VRA with Canada?

Ambassador YEUTTER. No, for that reason. But let me go on to embellish that by saying that we share the concern that some members of the industry have had about the possibility of Canada taking advantage of the President's steel program.

We think the President's steel program, Mr. Chairman and Senator Specter, has worked awfully well, and we believe that 90-plus percent of the people in the steel industry agree that it has worked awfully well. It has done exactly what we said it would do and the import penetration is way lower than it was before, and we think it has been a major success.

We have indicated to Canada and other non-VRA countries that we will not let them take advantage of the program by putting product in here in an inordinant way, even though they are fair traders, and thereby jeopardize the impact of the President's steel program. So that holds with or without an FTA, our commitments there.

Senator SPECTER. How are you going to stop them?

Ambassador YEUTTER. Well, we have got ways of doing that. We have had a number of jawboning sessions with our Canadian friends already and we believe that they have really been quite responsive.

I think Ambassador Murphy had one other point that he wanted to make, also, so let me ask him to do so.

Ambassador MURPHY. Well, in our actions where it says global actions, global actions unless imports from that party are substantial and are contributing importantly to serious injury.

Well, we determined what that should be on the basis of steel, and on that basis we were mindful of it and did not in any way exempt steel. You should also be aware that when we went into these negotiations, it was a free trade negotiation. Free trade negotiations in the steel industry, I think, would bring about a certain fear factor for most people in the steel industry.

We worked very hard with the steel industry and the private sector group and I think we have done an adequate job in terms of protecting them against actions in the future.

Senator METZENBAUM. Would you identify yourself, please?

Ambassador MURPHY. I am Dean Murphy, the chief negotiator for the U.S.-Canada talks.

Senator SPECTER. Well, just a concluding statement.

Senator METZENBAUM. Sure.

Senator SPECTER. I understand the point you are making, but it seems to me that this either is or would have been a good opportunity to have raised this issue with the Canadians. I can understand the difference between free trade, which the Free Trade Agreement has, and putting a voluntary restraint on, which is contrary to free trade, but the currents flow in a lot of different directions.

I understand the point you are making about fair trade and your conclusion that there are not unfair Canadian trading practices, but at the same time you want to be sure that they do not take any

unfair advantage of the market conditions to increase their percentage.

The difficulty is that the steel industry still has problems and these are not matters which we can respond to really very rapidly. Sometimes, before we know it, a significant change has occurred and there is very serious prejudice to the steel industry.

That is an industry which, in my opinion, shared by many others, has been very substantially prejudiced up until the present time, and that is why these inquiries are being made and the point is being noted that this might have been a unique opportunity to have done something for the steel industry along the lines of a VRA.

You may be entirely right, Mr. Ambassador, that the time has passed, and I am not saying that this issue is going to defeat the Free Trade Agreement, because there is a lot of interest in it.

Perhaps it is a matter for the future that if there should be a recurrence of this opportunity, it ought to be taken advantage of, and perhaps these hearings will be important to put our Canadian friends on notice that we would expect some voluntary, voluntary restraints, some restraints that are voluntary without a voluntary agreement.

Ambassador YEUTTER. Well, we are committed, Mr. Chairman and Senator Specter, to make sure that our Canadian friends do not take advantage of the VRA program, and we will continue to operate on that issue just as we have in the past.

But I think, Senator Specter, we should not underestimate, as the steel workers seem to have done, some of the benefits that are in the FTA already. I noticed a tendency on the part of some industries as the FTA has come under evaluation and scrutiny here to take positions that are based upon expectations or objectives that the industry may have had rather than comparing the work product of the FTA with the status quo.

The question is, you know, is the industry better off or is it not better off than it would be in the absence of an FTA and, in my judgment, the steel industry is clearly better off. It is the winner on the tariff part of the negotiations because Canadian tariffs are going to come down more than our tariffs will. That has got to work advantageously.

To the degree that you have an expansion of economic activity and demand, the steel industry wins generally in both countries. In the absence of an FTA, that is not going to happen and that additional demand generation and creation is not going to occur, and somebody ought to be appreciative of that.

There were concerns about the melted and pour provisions in the trade bill as to whether those are going to be in any way jeopardized by the FTA. They are not. We made sure that was going to happen.

There are rules of origin in the FTA that, in my judgment, are better than the rules of origin that exist today. That is going to be at least somewhat helpful to the steel industry.

In terms of just generally raising issues about steel with the Canadians, we have consultative provisions in the FTA that do not exist presently, and it will be easier for your industry to raise questions than has been the case in the past.

So if you add all that together, it seems to me, Mr. Chairman—and I am sorry you missed that kind of general summary. I think there are four or five or six different areas in which the FTA is an advancement over the status quo.

Senator METZENBAUM. Mr. Ambassador, let me say this. We are sort of operating on an illusory plateau. As I understand the testimony today, we now have 60 percent of the steel capacity that we had in the past.

The steel industry had $26.8 billion in revenues, according to the representations made here, made $1.1 billion in capital expenditures, earned $1 billion, including 50 percent of that from the investment tax credit, retroactive, and 25 percent of it from asset sales.

My economic judgment would indicate that that is really not a very healthy industry. It is operating at 95 percent of capacity. It still is not making very much money, and these men here are saying, at least the gentlemen representing the steel producers, that they are concerned that if there is not a VRA, they are opposed to the FTA.

I am concerned for two reasons. One is steel is an important industry in my own State, but putting aside that kind of personal consideration, without an American steel industry we do not have a strong America. We cannot have a military, we cannot have a strong military. Without a strong military, we are a second-class or third-class world power.

It is not secret that not too many months ago, there really was a concern about not only LTV going into Chapter 11, but two other companies were talked about at that time as going into Chapter 11 and it was almost a day-by-day kind of situation.

Ambassador YEUTTER. Yes.

Senator METZENBAUM. The other company that has had trouble, my recollection is, is Wheeling-Pitt.

Now, as we sit here today, we are talking about the FTA going into effect and saying, well, we cannot get into a VRA with Canada at this point. I think it is a separate issue, and I think you did say that you could start negotiating a VRA with Canada.

I guess my real question with you is will you, and I think it is very relative to the Senate's consideration of the FTA and I do not think that there is any real assurance at this moment that the Senate is prepared to act favorably on the FTA.

I know it would certainly make some difference to this Senator, and I think there are many others who are concerned. When I say this Senator, I am also talking about the 36 members of the Steel Caucus, and I am not saying that each one of them is going to act to be that concerned about it.

But I do believe we have a real concern about the viability of the American steel industry, and I do not think we can just say, well, they are operating at 95 percent of capacity, they are making a profit.

Gosh, if these are profits, I would hate to see—I do not think these are profits in a real significant sense at all. I am wondering, A, whether—go ahead, Mr. Garvey.

Mr. GARVEY. Mr. Chairman, I would like to make one clarification.

Senator METZENBAUM. Sure.

Mr. GARVEY. Our request for a VRA was in the absence of achieving parity under the FTA.

Senator METZENBAUM. In the absence of what?

Mr. GARVEY. Achieving parity of the two currencies under the FTA. We felt that the disparity now creates a significant advantage for the Canadian steel producers, and your question to me was if that was not achieved, would you be requesting a VRA, and my answer was yes.

Senator METZENBAUM. I think that is correct, and I think it was on the assumption that there is not parity with respect to the value of the dollar.

Mr. GARVEY. Right.

Senator METZENBAUM. I appreciate that.

Mr. Deaner, do you have anything you want to add at this point?

Mr. DEANER. No. I think I have pretty well covered my testimony.

Senator METZENBAUM. Mr. Weigel?

Mr. WEIGEL. No, Mr. Chairman, I do not.

Senator METZENBAUM. Mr. Atwell?

Mr. ATWELL. My only suggestion would be that you might think about accelerating the decline of the Canadian tariff. They have an advantage now and they will continue to have an advantage for the next 10 years. The goal should be free trade and fair trade. It would make sense to have the Canadian tariff accelerate and decline maybe twice as fast until it reached parity and then decline at the same rate.

The goal is to achieve equilibrium and fair treatment, so I believe this would be an intelligent approach.

Ambassador YEUTTER. Well, we would be glad to go back and negotiate on that, but obviously somebody has to pay for that. The question is, you know, is there somebody in the U.S. steel industry that is willing to pay in some other way for that happening.

You know, you cannot expect a trading partner to make those kinds of concessions for free. If they are unskilled negotiators, they might, but our Canadian friends are really not unskilled negotiators. So, you know, there have to be trade-offs in all of that, obviously.

If I may just add a couple of comments, Mr. Chairman, to what you just said, first of all, I hope every member of the Senate votes on this package on the basis of what it will do for the United States as a whole.

This is truly historic. People have been talking about trying to do a U.S.-Canada free trade arrangement for well over a century and it looks as if we finally have an opportunity for a breakthrough here that could be of immense value to both countries.

You know, it may be an event that will truly change the course of history in both the United States and Canada, and it would be tragic if we missed that opportunity. I hope, also, however—and obviously you will vote on the basis of what is best for Ohio.

I happen to think that in this case it is an easy vote for you and anybody else from Ohio, Mr. Chairman, because this is a case where the national interest and Ohio's interests come together.

Ohio already has a very substantial positive balance of trade with Canada, well over $1 billion, and I look for States like Ohio and Pennsylvania to be among the major winners in this exercise over the next 10 or 20 or 30 years. So I think Ohio as a State will clearly be a significant beneficiary.

Coming down, zeroing down to steel, there is no doubt in my mind that the U.S. steel industry will be a net beneficiary of this agreement, no doubt. So for anyone to vote against the FTA, ignoring the national interest, ignoring State interest, and just say what will it or will it not do for the steel industry—I have to come to the conclusion that the FTA is a net positive for the steel industry, and I would be willing to debate at great length with anybody who would come to a contrary conclusion because I am confident that it is.

So for representatives of the industry, whoever they may be, to suggest to you, Mr. Chairman, that you should vote against the FTA or to take a position in their organizations in opposition to the FTA because it does not incorporate a VRA, in my judgment, is a classic example of folks shooting themselves in the foot and I would hope that they would reconsider their shooting-themselves-in-the-foot stances.

Senator METZENBAUM. Well, Mr. Ambassador, let me say that I think you are to be congratulated on negotiating the agreement.

Ambassador YEUTTER. Thank you.

Senator METZENBAUM. And I think that an overwhelming majority of us in the Senate would like to vote for it, but I also would say to you that I think you might make our task easier by negotiating a VRA with the Canadians prior to the matter coming to a vote on the floor of the Senate.

I am not going to say to you that that is a condition precedent. I am going to say it is a factor that I am certain will be taken into consideration by many of us. I would say to you also that I think all of us do have a concern about the national interest, but there are not any of us who do not recognize our obligation to represent our own State.

Ambassador YEUTTER. Sure.

Senator METZENBAUM. And although you mentioned that the dollar volume balance between Canada and Ohio is favorable to Ohio, in connection with the matter of steel, it is not favorable and steel is a critically important factor to our State. We have gone through the LTV situation. You can go to Youngstown; it is a community that has just been decimated by the closure of so many steel plants.

I would hope that with all of the other balls that you are bouncing in your hands these days that you might urge Ambassador Murphy to see if he could not move forward with a VRA with the Canadians at an early date. I think it would at least help us in the consideration of this matter.

Having said that, unless somebody else is bursting with some great gem of wisdom that we ought to share together, this subcommittee stands adjourned.

[Whereupon, at 11:48 p.m., the subcommittee and the caucus were adjourned.]

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